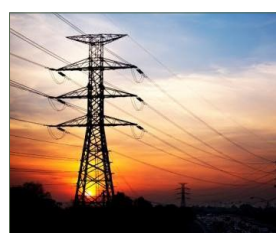


Gas to the West Licence Applications

Final Decisions
18 November 2014



About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our Mission

Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference

Act with integrity.

Abstract

In order to facilitate the extension of the Northern Ireland natural gas network to towns in the west of Northern Ireland, new licences must be granted by the Northern Ireland Authority for Utility Regulation. The Authority launched the application process for the licences on 6 February 2014 and eight applications were received.

The Authority has carried out an assessment of these applications against the criteria which the Department of Enterprise Trade and Investment have determined.

Following this assessment the Authority provisionally identified both a preferred applicant and a reserve applicant for the licence. The Authority's provisional conclusions were published for consultation on 12 August 2014 and responses were sought by 7 October 2014. Five responses were received by the deadline and these are published on the Authority's website.

This document presents a summary of the responses together with the Authority's response to them. The Authority's final decision is that NIEH and SGN are the preferred applicants for the purpose of the licence competition.

Audience

Applicants for the conveyance licences in the west of Northern Ireland, potential investors in Northern Ireland gas network assets, regulated companies in the energy industry, government and other statutory bodies and consumer groups with an interest in the energy industry.

Consumer impact

Research conducted on behalf of the Department of Enterprise Trade & Investment (DETI) indicates that potentially 40,000 domestic and commercial customers will connect to the new gas network in Tyrone and Fermanagh. These customers will benefit from lower energy costs and society as a whole will benefit from lower carbon and other emissions.

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Executive Summary

In January 2013 the Northern Ireland Executive agreed to provide grant funding of up to £32.5m to assist the extension of the natural gas network in Northern Ireland to the following towns:

- Dungannon including Coalisland;
- Cookstown including Magherafelt;
- Enniskillen including Derrylin;
- Omagh;
- Strabane.

In order to convey gas to these towns, new or extended gas networks will need to be constructed. The owners of these networks require a licence to be granted to them by the Authority under Article 8 of the Gas (Northern Ireland) Order 1996 (The Gas Order). The Authority has previously determined that it will grant two exclusive gas conveyance licences in respect of the new networks by means of a competitive process using criteria determined by the Department of Enterprise Trade and Investment (DETI):

- one licence relating to the high pressure assets needed for the distribution of gas to the designated towns; and,
- the other licence relating to low pressure assets in the designated towns that are required for the distribution of gas to individually connected supply points.

DETI consulted on and determined assessment criteria (“Criteria”) that reflect a careful balance of considerations designed to ensure that the Authority has regard to all of the matters that DETI considers to be relevant to the evaluation of an application for a licence, and does so in a manner that is objective and non-discriminatory as between applicants.

The Authority launched the application process on 6 February 2014. The application period closed at noon on 6 May 2014, eight applications have been received, four for the high pressure licence and four for the low pressure licence. The Authority carried out an assessment of these applications against the relevant Criteria, and provisionally identified both a preferred and a reserve applicant for each licence.

The Authority's provisional conclusions were published on 12 August 2014 and included an explanation of how the Authority had interpreted and applied the Criteria¹ and what provisional judgments it had reached in assessing the applications against the Criteria in the light of the information and evidence provided by each of the applicants. Responses were sought by 7 October 2014.

Five responses were received by the deadline and the Authority has carefully considered each of these responses. This document presents a summary of the responses together with the Authority's response to them following consideration, and therefore the final conclusions reached by the Authority and the reasons for reaching those conclusions.

The Authority considers that its provisional conclusions were sound and should be confirmed. Therefore our final decision is that NIEH and SGN are the preferred applicants for the purposes of the licence competition.

	Gas Conveyance Licence Awarded	
	High Pressure	Low Pressure
Preferred Applicant	NIEH (Mutual Energy)	SGN (Scotia Gas)
Reserve Applicant	BGE UK	firmus

This final decision marks a key stage in delivering Gas to the West. The Authority's next step is to consult on the conditions of the relevant licences and we intend to commence consultation on each licence by the end of the year. Following licence grant it is anticipated that the licensees will seek the other formal approvals (such as planning) that are necessary to construct the new networks in the West.

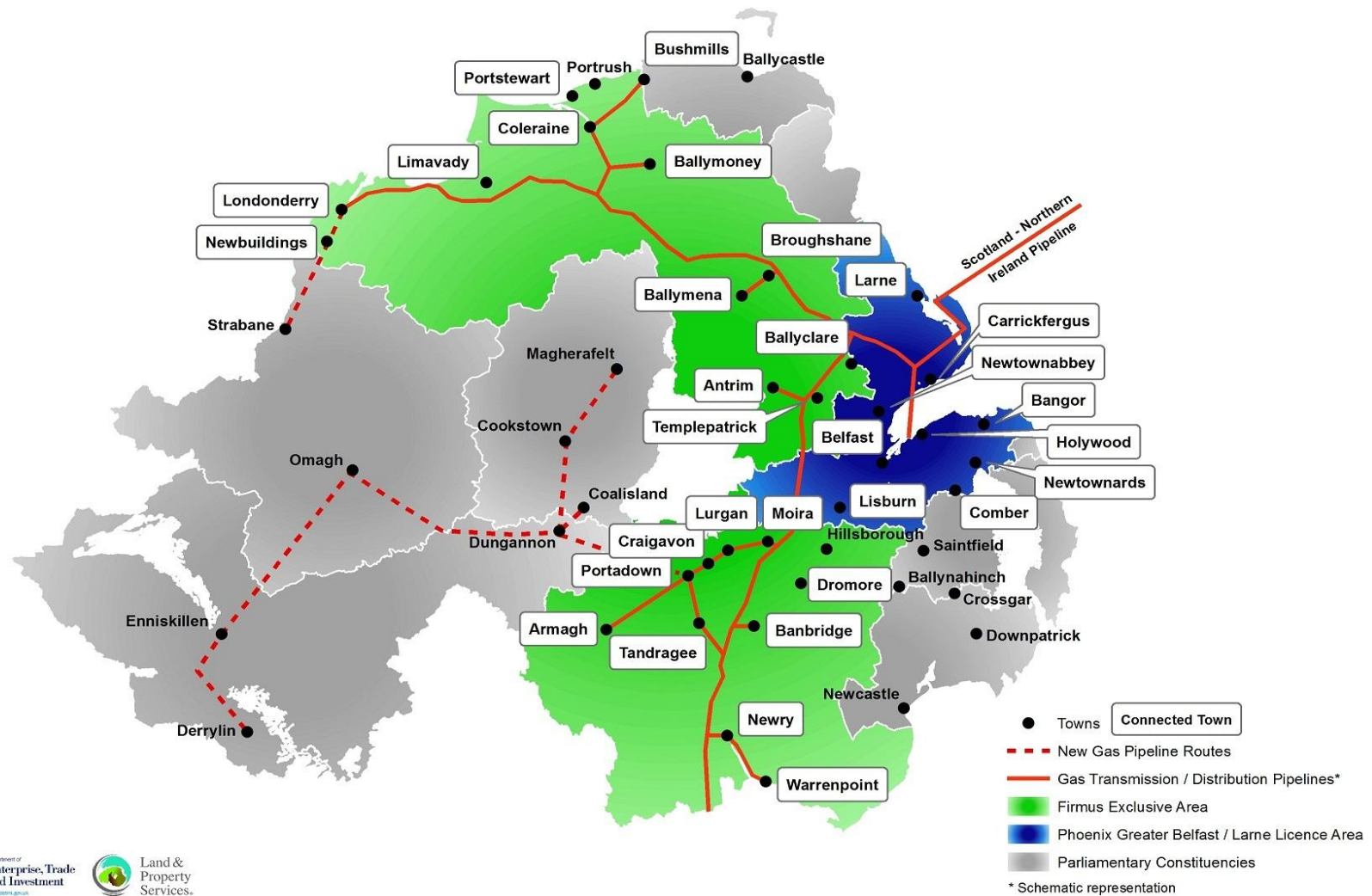
The new networks will deliver a net economic benefit to the Northern Ireland economy over the next forty years. The economic benefits will come not only from reduced carbon emissions but in particular reduced fuel costs for the up to 40,000 domestic and commercial consumers that will connect to the new gas network. Amongst commercial consumers who will benefit are some of Northern Ireland's largest food process and manufacturing facilities. It is anticipated that gas will become available in stages from 2016 onwards subject to the necessary environmental and planning consents being

¹ See chapter 2 of the Provisional Determination.

secured in a timely way. A map of the Northern Ireland Gas industry including the illustrative route of the new network is included overleaf.

18 November 2014

Natural Gas Availability in Northern Ireland



1.0 Introduction

1.1. Introduction

1.1.1 In January 2013 the Northern Ireland Executive agreed to provide grant funding of up to £32.5m to facilitate the extension of the Northern Ireland natural gas network to the following towns:

- Dungannon including Coalisland;
- Cookstown including Magherafelt;
- Enniskillen including Derrylin;
- Omagh;
- Strabane.

1.1.2 In order to convey gas to these towns, new or extended gas networks will need to be constructed. The owners of these networks will require licences to be granted to them by the Northern Ireland Authority for Utility Regulation (**the Authority**) under Article 8 of the Gas (Northern Ireland) Order 1996 (**the Gas Order**).

1.1.3 The Authority has indicated that it proposes to grant two gas conveyance licences in respect of the networks:

- a. one licence relating to the high pressure assets needed for the distribution of gas to the designated towns;
- b. the other licence relating to low pressure assets in the designated towns that are required for the distribution of gas to individually connected supply points.

1.1.4 Each licence will be 'exclusive'. This means that, once it has been granted, no new gas conveyance licence can be granted in relation to the area covered by that licence for a specified period of time. The Authority intends the exclusivity

period to be five years in the case of the high pressure licence and twenty years in the case of the low pressure licence. For that reason, and since a number of companies have expressed interest in obtaining the licences and developing the networks, the Authority is facilitating a competition to determine who should be granted the licences.

- 1.1.5 The Authority launched the application process for the licences on 6 February 2014. The period during which applications could be submitted closed at noon on 6 May 2014. Eight applications (**the applications**) were received from the companies (**the applicants**) set out in the table below.

High pressure licence applications	BGE (UK) Ltd – application connected to the firmus Energy Distribution Ltd low pressure application.
	BGE (UK) Ltd – unconnected application.
	Northern Ireland Energy Holdings Ltd – application connected to the Scotia Gas Networks (Northern Ireland) Ltd low pressure application.
	Phoenix Natural Gas Ltd – application connected to the Phoenix Natural Gas Ltd low pressure application.
Low pressure licence applications	firmus energy Distribution Ltd – application connected to the BGE (UK) Ltd high pressure application.
	firmus energy Distribution Ltd – unconnected application.
	Phoenix Natural Gas Ltd – application connected to the Phoenix Natural Gas Ltd high pressure application.
	Scotia Gas Networks (Northern Ireland) Ltd – application connected to the Northern Ireland Energy Holdings Ltd high pressure application.

- 1.1.6 The Authority has carried out an assessment of these applications against the criteria which the Department of Enterprise Trade and Investment (**DETI**) have determined and published for that purpose under Article 8(7B) of the Gas Order (**the Criteria**).
- 1.1.7 Following this assessment the Authority has provisionally identified both a preferred applicant and a reserve applicant for each licence. The Authority's provisional conclusions were published for consultation on 12 August 2014 and responses were sought by 7 October 2014. Five responses were received by the deadline and the Authority has carefully considered each of these responses.
- 1.1.8 This document therefore presents a summary of the responses together with the Authority's response to them following consideration and sets out the final conclusions of the Authority for the purposes of the licence competition.
- 1.1.9 The Authority's next step is to publish the conditions of the licences to be granted for consultation and we intend to do this by the end of the year.

1.2. Purposes of this Document

- 1.2.1 The purposes of this document are to:
- a. describe the final conclusions reached by the Authority in assessing the licence applications against the Criteria;
 - b. set out its reasons for reaching those final conclusions, including a summary of the responses received to the consultation on the provisional decisions. The responses to the provisional decisions are published alongside this document on the Authority's website;
 - c. confirm the identity of the preferred and reserve applicants.

1.3. Structure of this Document

- 1.3.1 This document contains the following sections:
- Executive Summary

- Chapter 1: Introduction – This introduces the competition and sets out the purpose of this document.
- Chapter 2: Consultation Responses – This summarises the responses received to the consultation on the provisional decisions and explains how the Authority has taken these into account in reaching its final decision.
- Chapters 3 to 10: Applications – These chapters set out the Authority's final decision in relation to each of the eight applications and its reasons for reaching them.
- Chapter 11: Best Value Criterion – This explains the effects of the Authority's final conclusions for the purpose of identifying the preferred and reserve applicants under the Criteria.
- Chapter 12: Next Steps – This sets out the next steps that the Authority proposes to take following the issue of this document up to the grant of the licences, and gives an indication of the expected timetable.
- Appendix A: Links to responses to the provisional decisions published on the Authority's website.
- Appendix B: Glossary – This lists and explains the key terms used in this document and provides further explanatory material to assist stakeholders in understanding the background to some of the economic issues being consulted upon.
- Appendix C: Economic Terms – This lists and explains the key economic terms which have been used throughout the document.
- Appendix D: Overview of Applicants – This gives a brief overview of each company which has applied, including whether they hold any current licence.

2.0 Consultation Responses

2.1. The Responses

2.1.1 The Authority published its consultation on the provisional decisions relating to the preferred and reserve applicants (the **Consultation**) on 12 August 2014.

2.1.2 Responses were sought from all interested parties by 5pm on 7 October 2014. Five responses were received by this deadline from:

- BGE(UK) Ltd;
- firmus energy;
- Mutual Energy Ltd (MEL);
- Scotia Gas Networks Ltd (SGN);
- SSE Airtricity (SSE).

2.1.3 No further responses were received after the consultation deadline.

2.1.4 All but one of the applicants (Phoenix Natural Gas Ltd (PNGL)) responded to the consultation. The fifth response was from SSE Airtricity, a related company of SGN.

2.1.5 None of the respondents requested that any part of its response should be treated as confidential and withheld from publication. The Authority is therefore publishing all of the responses together with this Final Decision.

2.2. Brief Summary of the Responses

2.2.1 The Authority carefully considered each of the responses received.

2.2.2 One respondent SSE, made some general observations on the process for the award of the licences and its provisional outcome.

2.2.3 The other four respondents, each of which is (or is a member of the corporate group of) one of companies provisionally named as a preferred or reserve

Consultation Responses

applicant, made specific comments on aspects of the Authority's reasoning, its provisional scoring or the issues likely to arise on the grant of the licences.

- 2.2.4 Where a respondent questioned an aspect of the Authority's reasoning or the mark that had provisionally been allocated in respect of any element of the Criteria, either in relation to its own application or that of another applicant, the Authority carefully considered whether, in light of the representations made, it would be appropriate to make any change to the provisional reasoning or mark identified.
- 2.2.5 Where a respondent raised issues relevant to the grant of the licences, for instance in relation to the conditions to be included in a licence, the Authority noted them for the purpose of its future actions and will take them into account as part of the consultation on the licence conditions. Most of these points, however, have no immediate bearing on the decisions, in accordance with the Criteria, to identify the preferred and reserve applicants for each licence.
- 2.2.6 A short summary of each of the points raised by the respondents is set out in this Chapter, together with the Authority's response.
- 2.2.7 Where, as was the case in relation to the large majority of the issues addressed in the Consultation, no specific responses were received, the Authority has considered that its provisional conclusions were sound and can become final conclusions for the purposes of the overall competition.
- 2.2.8 Sections 2.3-2.7 below summarise each response received and how the Authority has taken these into account in arriving at its Final Decision.

2.3. BGE(UK) Response

Overall Scoring of OBP and ITT

- 2.3.1 BGE(UK) stated that it did not believe that its scoring in relation to the Operational Business Plan and Information and Technology Transfer², when viewed relative to that of other applicants, fully reflected the strength of its application, in particular its experience in the management of high pressure

² Chapters 3.5 to 3.8 and 4.5 to 4.8 of the Consultation.

Consultation Responses

pipelines.

- 2.3.2 However, aside from making this assertion, BGE(UK) stated that it would '*not seek to counter or challenge the evaluation and scoring*' of its application, and noted that in this respect the Authority has '*significant discretion*'.
- 2.3.3 The Authority reviewed its scoring against the relevant Criteria for the purpose of reaching its final conclusions. In doing so, it noted BGE(UK)'s comments, but in the absence of any more particularised challenge to the provisional marks did not consider that there was any ground for changing those marks. It remained satisfied in particular that the provisional marks had given BGE(UK) appropriate credit for its experience when compared with other applicants, and noted in this regard that one other respondent (Mutual Energy, see further below) commented, from the opposite perspective of the NIEH application, that too much credit was given to the BGE(UK) application for experience.
- 2.3.4 Having regard to both of these representations, the Authority considered that it had formed a reasonable and balanced judgment for the purposes of the provisional scoring. In this context it noted that BGE(UK) was not in any event seeking to challenge its evaluation, and that BGE(UK) had fairly and correctly recognised that the process of scoring involves the exercise of discretion by the Authority. The Authority is content that its provisional marks for the BGE(UK) applications were an appropriate exercise of that discretion and remain so when expressed as final marks.

The NIEH WACC

- 2.3.5 BGE(UK) questioned whether the Weighted Average Cost of Capital submitted by the provisional preferred applicant, NIEH, was consistent with the stated intention of the Authority as to the nature of the price control to be included in the licence of the preferred applicant.
- 2.3.6 The Authority previously indicated that the cost of capital to be reflected in the price control, in particular in the first control period, would '*equal as far as reasonable the costs revealed by the competitive process*'. BGE(UK) noted that, in its application, NIEH said that it would raise long-term bond finance only after the end of the construction process. BGE(UK) asked for clarity as to the

Consultation Responses

consequences if, in the event of changes in the bond market between now and then, NIEH was unable to raise finance at the cost assumed in its application.

2.3.7 The Authority noted that this is not a question which bears directly on its provisional or final conclusions as to the preferred applicant. In the application of the Criteria for this purpose, the Authority does not have discretion as to the treatment of the Applicant Determined Costs³. Instead, BGE(UK) had raised a question which was about the conditions of the licence to be granted to the preferred applicant.

2.3.8 In response to a clarification question about the relationship between the WACC submitted by a preferred applicant and the conditions of its subsequent licence, the Authority previously said this:

'The Authority has not set out any proposals to write elements of the WACC into the licence.

The Authority has not set out a minimum period for which the "tender WACC" would apply. As set out in the Applicant Information Pack, for both the high pressure licence (para 3.29) and the low pressure licence (para 3.59):

"It is our intention that the cost of capital will equal as far as reasonable the costs revealed by the competitive process. This will particularly apply in the first price control period. In setting the cost of capital at future reviews we would expect to apply the CAPM model."

In making future determinations the Authority will take account of the capital structure revealed in the licence application process and whether it remains appropriate. In addition the Authority will consider the level of risk, how market conditions may have changed over time, and all other relevant circumstances.

The Capital Asset Pricing Model will be one of a number of tools available to the Authority that is likely to have some use in making these various

³ Chapter 2.8.8 to 2.8.11 of the Consultation.

assessments.⁴

- 2.3.9 The Authority cannot expand significantly on this statement at the present time. It is clearly the intention of the Authority to base the cost of capital in a licence granted to the preferred applicant on the WACC revealed by the application process. But the statement that it will do so '*as far as reasonable*' reflects the fact that it must also have regard to changes in circumstance as they affect the licence holder, not least in future price control periods which are distant in time from the competition for the licence.
- 2.3.10 While the WACC revealed by the application process will therefore be a key factor in setting a price control, the Authority will determine the control, as all other licence conditions of the licence, on the basis of its principal objective and general duties under Article 14 of the Energy Order, having regard to all relevant matters.
- 2.3.11 It should be noted that such conditions in the licence will be subject to further public consultation before they are made or modified, and all stakeholders will have the opportunity to make further representations at that time.

2.4. firmus energy Response

The Criteria and the Scoring of Opex

- 2.4.1 firmus stated that in its opinion the Criteria for allocating a mark in relation to the Applicant Determined Costs '*placed undue weight on the fact that the preferred applicant's [i.e. SGN's] submission reported lower operating costs (opex) than other applicants*', and expressed the concern that the assumptions underpinning these figures would turn out to be '*optimistic*'. Therefore, it stated, the Authority's provisional conclusions must carry '*a number of risks for customers in NI*'.
- 2.4.2 However, as firmus acknowledges, and as has been noted above, the Authority had no discretion as to the treatment of the Applicant Determined Costs⁵. The role of the Authority was to apply the Criteria as set by DETI, and the Criteria have been in place for some time and were subject to extensive consultation for

⁴ Clarification Questions, answer to question 18.

⁵ Chapter 2.8.8 to 2.8.11 of the Consultation.

Consultation Responses

the purposes of the G2W competition before they were framed in their current terms⁶.

- 2.4.3 The Authority considered the point raised by firmus, but was satisfied that it related to the terms of the Criteria, which cannot be amended, rather than to the Authority's application of them. Therefore the Authority considered that this was a point that could not have any bearing on its [Final Decision].
- 2.4.4 firmus' response also makes some more particular points about the level of resources which SGN proposes to have available (particularly in relation to the management of safety issues).
- 2.4.5 The Authority notes that safety falls under the remit of HSE(NI). With this in mind we clearly stated in the workbook notes for the low pressure licences that review of safety cases are a matter for the HSE(NI). HSE(NI) will therefore judge what actions are necessary to ensure safety but the allowance will be based on the application. We remain satisfied that SGN in its application demonstrated the necessary skills and experience in relation to system operation, including emergency response and safety.⁷
- 2.4.6 firmus also makes more general points about the inadequacy of the description by SGN of its derivation of cost data. We noted in arriving at our provisional conclusions that the derivation of SGN costs was difficult to follow in some of the calculations⁸ and we also identified a number of errors in the operating expenditure submission. These factors were taken into consideration in arriving at provisional scores for SGN. The Authority therefore remains content with the scores issued to SGN in the provisional determination paper. Accordingly it is not necessary to revisit provisional scores and they can be confirmed.

Increases in Opex Allowances

- 2.4.7 firmus stated that it would be '*extremely disappointed if the opex allowed for the preferred applicant in the initial G2W price control period were materially higher than that identified in the submission on which the UR's decision was based*'.

⁶ Chapter 1.5.10 to 1.5.16 of the Consultation.

⁷ Chapter 10.7.9 to 10.7.14 of the Consultation.

⁸ Chapter 10.6.13 of the Consultation.

Consultation Responses

- 2.4.8 firmus expressed the view that material increases to opex would need to be justified by reference to changes in underlying costs, rather than being allowed simply because assumptions made in the application proved to be ambitious.
- 2.4.9 As with BGE's submission about the NIEH WACC, the Authority noted that this is not a question which bears directly on its provisional or final conclusions as to the preferred applicant, but is instead a question about the conditions of the licence to be granted to the preferred applicant.
- 2.4.10 However, for clarity, the Authority's position in relation to the opex allowances remains as it was stated prior to the competition:

'As set out in the Conclusions paper we believe that a direct link between the cost information revealed in the application and the allowances provided in subsequent price controls will act as a powerful incentive to ensure that applicants reveal realistic cost information and that some link should be maintained beyond the first price control period. In particular we would not be minded to accept requests for increased allowances as a consequence of changes in the structure of costs or changes in the allocation of costs from parent or holding companies. However, we will consider requests for different allowances where these are the result of unforeseen significant changes in the market since the application was submitted.

We recognise that, over the passage of time, it is likely to become less feasible to continue to directly link allowances to the application. When allowances are set at periodic reviews we will take account of the latest information and any changes in circumstances, and will not continue to link them to the application if that would cause them to be inappropriate in all the circumstances prevailing at the relevant time. To mitigate this issue we will increasingly rely on the cost drivers and other relevant factors identified in the applicant's operational business plan.'⁹

- 2.4.11 In short, it is clearly the intention of the Authority to base the opex allowances in the low pressure licence granted to the preferred applicant on the opex revealed

⁹ Applicant Information Pack, paragraphs 3.44 to 3.45.

Consultation Responses

by the application process. However, it must determine the price control on the basis of its principal objective and general duties under Article 14 of the Energy Order, having regard to all relevant matters including material changes in circumstance.

- 2.4.12 It should be noted that the price control conditions in the licence of the preferred applicant will be subject to further public consultation before they are made or modified, and all stakeholders will have the opportunity to make further representations at that time.

Clarity as to Terms of Joint Venture

- 2.4.13 firmus noted that the provisional preferred applicant for the low pressure licence (SGN) '*proposes to enter into a Joint Venture (JV) arrangement*' with the preferred applicant for the high pressure licence (NIEH).

- 2.4.14 It then expressed a number of 'assumptions' about the joint venture, namely that:

- a. the Authority had seen a '*fully documented and formalised JV*';
- b. the joint venture was negotiated on arm's length terms, and that the Authority is satisfied that there is no scope for cross-subsidy;
- c. the Authority has been provided with adequate comfort that the joint venture was formed in accordance with applicable procurement legislation; and
- d. the Authority has been provided with details as to the basis on which SGN will extend its existing contracts to accommodate the extension of its operations to Northern Ireland.

- 2.4.15 The Authority's approach to the information and evidence provided by each of the applicants, and its use in assessing the applications against the Criteria, was clearly set out at Chapter 1.5.17 to 1.5.24 of the Consultation.

- 2.4.16 As to the joint venture between NIEH and SGN, Chapter 5.5.17 of the Consultation stated:

'The Authority was satisfied in principle that, where an applicant lacks the

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skills and experience to meet some of the obligations under the conditions of the high pressure licence, a contractual joint venture with an organisation possessing the relevant skills and experience was an appropriate means by which the required resources could be accessed. The Authority noted that NIEH stated that its JV with SGN was already established, and that this was reflected in the fact that the organisations had made connected applications for the high and low pressure licences.'

- 2.4.17 The Authority considered firmus' arguments, but did not consider that they ought to have any weight in its assessment for the purposes of the Final Decision as there was no requirement to review the joint venture in detail.
- 2.4.18 The Authority was not provided by either SGN or NIEH with a copy of a '*fully documented*' joint venture agreement and, as explained in Chapter 1.5.17 to 1.5.24 of the Consultation, the Authority assessed all applications only on the basis of such information and evidence as was provided.
- 2.4.19 Indeed the Authority noted that it was not provided with contractual documentation by any of the applicants, including firmus itself, whose 'partnership' with BGE(UK) – an entity which, at the time at which the provisional conclusions were reached, was no longer part of the same corporate group as firmus – was a relevant feature of both its connected and unconnected applications¹⁰.
- 2.4.20 The Authority would have considered any such information if provided, but would not necessarily have expected to see it, and in any event would not have expected to assess it for such matters as the legality of the procurement process by which it was established.
- 2.4.21 In the case of NIEH and SGN, the Authority was sufficiently satisfied by reference to the clear information provided by both applicants, reflected in the fact of connected applications made by them, that a joint venture arrangement was in place. It also noted that, unlike firmus and BGE(UK), neither applicant submitted an unconnected version of its connected application.
- 2.4.22 Should the preferred applicants be granted the G2W licences, they will be

¹⁰ See, for instance, Chapters 7.5.7 and 8.5.7 of the Consultation.

subject to the conditions of their licences, and each will have the regulatory responsibility – amenable to the Authority's powers of enforcement and sanction – for ensuring that their underlying contractual arrangements are adequate to enable them to comply with their obligations. This is a standard regulatory treatment of all licence holders, and the Authority considered there to be no reason to depart from it in the case of the G2W licences.

- 2.4.23 With regard to cross-subsidies, the Authority noted that there would be conditions of the G2W licences in place which would be designed to identify any prohibited cross-subsidy. These conditions will be subject to further public consultation before they are made or modified, and all stakeholders will have the opportunity to make further representations at that time. Any concern (implicit in its response) that firmus has as to the adequacy of those conditions can be raised as part of that consultation process and is not of direct relevance to the Final Decision.

2.5. Mutual Energy Ltd Response

NIEH 'Disadvantaged'

- 2.5.1 Mutual Energy noted that one applicant (PNGL) was given a mark in relation to its Applicant Determined Costs against which others were benchmarked, even though that applicant then failed against the Resources Criteria. It stated that, while this did not affect the outcome, the NIEH application was nonetheless *'disadvantaged by losing 37.5 marks out of a possible 50 by being marked against a bid which was clearly without proper evidence'*.
- 2.5.2 The Authority noted that this is not a question which bears directly on its provisional or final conclusions as to the preferred applicant. As noted above, in the application of the Criteria, the Authority does not have discretion as to the treatment of the Applicant Determined Costs¹¹. The Authority must apply this sub-criterion and marks are calculated mathematically in accordance with the rules set out in the Criteria. The role of the Authority is to apply the Criteria as set by DETI, and the Criteria have been in place for some time and were subject to extensive consultation for the purposes of the G2W competition before they

¹¹ Chapter 2.8.8 to 2.8.11 of the Consultation.

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were framed in their current terms¹².

- 2.5.3 The Authority considered the point raised by Mutual Energy, but was satisfied that it related to the terms of the Criteria, which cannot be amended, rather than to the Authority's application of them. The Authority noted that it was a point that in any event had no practical bearing on its [Final Decision].

Stakeholder Engagement

- 2.5.4 Mutual Energy stated that it was '*surprised that the scoring of the applicants' proposal as to the engagement with key stakeholders favoured those having constructed pipelines in Northern Ireland*', and contended that the NIEH stakeholder engagement plan was more comprehensive than that of any other applicant.
- 2.5.5 The Authority reconsidered this aspect of its provisional scoring in the light of the response from Mutual Energy. However, it was satisfied that its initial judgments were sound. It did not consider that they involved 'favouring' those who happen to have constructed high pressure pipelines in Northern Ireland, but rather of giving appropriate weight to experience gained by doing so, and in particular to the way in which BGE(UK) reflected the benefit of that experience in its stakeholder engagement proposals.

Identification of Staff

- 2.5.6 Mutual Energy noted that the NIEH application identified named key individuals, and asserted that this was '*clearly superior*' to identifying a pool from which staff will be drawn. It also stated that NIEH had given a clear indication of where framework contracts would be needed.
- 2.5.7 The Authority considered that it was helpful to be provided with the details of named individuals whom it was proposed would be engaged on the G2W project, but noted that it had also recognised and given credit for this in its provisional conclusions¹³ as it had to the extent that other applicants were also

¹² Chapter 1.5.10 to 1.5.16 of the Consultation.

¹³ Chapter 5.5.10 to 5.5.15 and 5.5.18 to 5.5.19 of the Consultation.

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able to name individuals¹⁴.

- 2.5.8 The Authority did not consider, however, that this was a matter which necessarily attracted significant weight. What was most important was that it was clear from an application that appropriately skilled, qualified and experienced individuals would be available, whether or not individuals could be named at this stage.
- 2.5.9 Similarly, the Authority noted that it had taken account in its provisional conclusions of the clarity of NIEH's position with regard to the use of framework contracts, which gave a '*good indication of what roles would require to be filled and what the process would be for filling them*'¹⁵.
- 2.5.10 The Authority was therefore satisfied that NIEH had been given sufficient credit for these matters in its provisional conclusions and the provisional scoring, and that it was appropriate to confirm these. It did not consider that the submissions made by Mutual Energy raised any issues that required a change to those conclusions or the associated marks.

Identification and Management of Risk

- 2.5.11 Mutual Energy wished to draw the Authority's attention specifically to figures 4.1.3a to 4.1.3d in NIEH's application, which it stated meet the Authority's interpretation of what is required by a good risk management plan, namely one that identifies project risks and deals with both the probability and impact of a risk occurring.
- 2.5.12 The Authority considered Mutual Energy's submission, and noted that, while it had not specifically referred to figures 4.1.3a to 4.1.3d in its Consultation, it had taken them into account in reaching the provisional conclusion set out in the Consultation, that:

'NIEH has demonstrated that it has robust systems in place for the identification and management of risks, and that it has provided some evidence that its approach to risk has been applied to identify a number of specific risks relating to the G2W project and suggest means of their

¹⁴ For instance, Chapter 3.5.13 to 3.5.16 of the Consultation.

¹⁵ Chapter 5.5.20 of the Consultation.

mitigation.¹⁶

- 2.5.13 This provisional conclusion was supported by advice from Rune, which had also considered the NIEH Operational Business Plan in detail.
- 2.5.14 The Authority was therefore satisfied that it had had proper regard to the matters to which its attention was drawn by Mutual Energy, both when reaching its provisional conclusions and setting the mark which the NIEH application provisionally attracted against sub-criterion 3.17(a).
- 2.5.15 The Authority therefore did not consider that there was anything in Mutual Energy's submission which had not already been fully taken into account. Having reviewed its provisional conclusions and scoring again for the purposes of the [Final Decision] it considered that they should be confirmed.

Debt Finance

- 2.5.16 Mutual Energy noted that the conditionality which was attached to NIEH's letters of comfort was only what would be expected of a project at this stage of development, and that it had evidence from its own experience of the ability to raise 100% debt finance.
- 2.5.17 The Authority considered this submission but noted that it merely reiterated what were clearly the Authority's own provisional conclusions as to the letters of comfort¹⁷ and NIEH's evidence of its history of raising debt finance¹⁸ which had been given full credit in the provisional score against sub-criterion 3.17(b)¹⁹.
- 2.5.18 The Authority therefore did not consider that there was anything in this submission which required an amendment to its provisional conclusions or marks.

Assumption on Use of Cash Reserves

- 2.5.19 Mutual Energy expressed surprise that NIEH's proposal to use cash reserves from its other gas businesses to fund transaction costs should not be considered

¹⁶ Chapter 5.5.26 of the Consultation.

¹⁷ Chapter 5.6.32 to 5.6.34 of the Consultation.

¹⁸ Chapter 5.6.36 of the Consultation.

¹⁹ Chapter 5.6.63 to 5.6.65 of the Consultation.

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as robust. It stated that obtaining the required consent of the Authority to this use was a '*safe assumption*'.

- 2.5.20 The Authority disagreed with this statement. It was not valid, still less 'safe', of NIEH to assume the Authority's consent to a particular treatment of cash reserves would be forthcoming without having sought that consent or obtained any assurances as to it. The Authority will consider any such application made in future on its merits at the time it is made, but noted at the present time that NIEH relied on an assumption as to a matter over which it does not have control. The Authority remains satisfied with its provisional conclusion that the assumption was not 'robust'²⁰.

Timely Delivery of High Pressure Network

- 2.5.21 Mutual Energy contended that '*little weight*' should be given to any proposals at this stage to replace high pressure with low pressure pipelines. It also stated that while the NIEH application aimed at a three year construction timeline, this did not seem to attract any benefit when measured against applications which indicated that four years was a more feasible timetable.
- 2.5.22 The Authority noted that it had explicitly given 'little weight' to NIEH's own proposal to substitute high pressure with low pressure pipelines, having regard to the advice from Rune, which Mutual Energy does not challenge, that the quality of the proposal was poor²¹. Limited weight was also given to the BGE(UK) proposal for substitution²², while the more detailed, credible and justified proposal of PNGL had been given greater weight²³.
- 2.5.23 Revisiting these provisional assessments in the light of Mutual Energy's response, the Authority was satisfied that they were correct. The substitution proposals were not a major factor in the overall scoring of sub-criterion 3.17(c), and the best of the applicants in relation to these proposals still achieved a low overall mark. However, all three applicants considered that substitution was an appropriate matter about which to make proposals. Rune's clear advice to the

²⁰ Chapter 5.6.50 of the Consultation.

²¹ Chapter 5.7.35 of the Consultation.

²² Chapter 3.7.39 of the Consultation.

²³ Chapter 6.7.35 of the Consultation.

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Authority was that certain applicants made better proposals than others. The Authority considered it appropriate in light of this that some credit should be given for the better submissions, and was satisfied that it had struck the right balance.

2.5.24 With regard to the question of timing, the Authority noted that in relation to the other applicants it had accepted the advice of Rune.

2.5.25 While BGE(UK) suggested the possibility of a four year timetable, it had produced a credible timeline for a three year construction period,²⁴ as had NIEH²⁵. The Authority did not consider that it would be appropriate for BGE(UK) to be given a lesser mark against the sub-criterion because it had questioned the specified timetable, particularly in circumstances in which it had also produced a credible plan to meet it. The Authority was satisfied that it had made appropriate judgments in relation to these matters in reaching its provisional conclusions and marks, and that it was not appropriate to adjust them.

2.6. Scotia Gas Networks Ltd

Points of Agreement

2.6.1 SGN expressed agreement with the Authority on a number of matters:

- a. that Chapters 1 and 2 of the Consultation represent a fair reflection of the information provided to applicants for the purposes of the competition;
- b. that a consistent WACC over the life of a project does not reflect the CAPM methodology;
- c. that it was inappropriate for PNGL to assume that Mutual Energy would acquire the high pressure assets without any prior agreement and at a cost of capital below that which NIEH had proposed in its application;
- d. that operating a mutual entity within a profit-making organisation may create problems of business separation;

²⁴ Chapter 3.7.36 of the Consultation.

²⁵ Chapter 5.7.34 of the Consultation

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- e. that it is important to the G2W project to demonstrate current capability in both the operation and construction of high pressure networks; and
 - f. that as a potential new entrant to the Northern Ireland market, SGN has not yet been able to engage with stakeholders as comprehensively or efficiently as incumbent entities.
- 2.6.2 Overall, SGN considered that the Authority had demonstrated a '*systematic and reasoned approach*' to the evaluation of the applications.

Debt Finance

- 2.6.3 SGN noted that the lack of any firm commitment from the banks at this stage, as reflected in the letters of comfort offered by NIEH, reflects the status of applicants within this part of the process, and that external financiers would rarely offer greater comfort at such an early stage.
- 2.6.4 The Authority considered this submission but, as in relation to the equivalent point made by Mutual Energy in its response, noted that it merely reiterated what were clearly the Authority's own provisional conclusions as to the letters of comfort. The Authority had not considered that there was anything inappropriate in the letters of comfort, but merely that they could be given little weight in light of the qualifications attached to them²⁶.
- 2.6.5 The Authority therefore did not consider that there was anything in this submission which required an amendment to its provisional conclusions or marks.

Best Value Criterion

- 2.6.6 SGN noted that the scoring mechanism gave credit to an application (that of PNGL) which depended on the applicant being able to sell the constructed asset to Mutual Energy on the assumption of a cost of capital lower than that which NIEH itself felt able to achieve. It considered that '*the deduction of 37.5 marks for NIEH is misaligned with the fact the PNGL bid was set aside*'.
- 2.6.7 The Authority noted that it had not 'deducted' any marks from NIEH, but merely

²⁶ Chapter 5.6.32 to 5.6.34 of the Consultation.

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applied the Criteria. As noted above, in the application of the Criteria, the Authority does not have discretion as to the treatment of the Applicant Determined Costs, which are applied mathematically in order to give rise to the relevant mark²⁷. There is no power for the Authority to discount the marks given to PNGL in this respect, notwithstanding that PNGL failed to satisfy other elements of the Criteria.

2.6.8 The role of the Authority is to systematically apply the Criteria as set by DETI. The criteria have been in place for some time and were subject to extensive consultation for the purposes of the G2W competition before they were framed in their current terms²⁸.

2.6.9 While the Authority therefore considered the point raised by SGN, it was satisfied that it related to the terms of the Criteria, which cannot be amended, rather than to the Authority's application of them. The Authority noted that it was a point that in any event had no practical bearing on its Final Decision.

2.7. SSE Airtricity

2.7.1 SSE Airtricity noted that its role in Northern Ireland is that of an energy supplier, in which capacity it welcomes the G2W project. It is owned by SSE plc, which is a part-owner of SGN.

2.7.2 SSE Airtricity indicated that it considered the competitive process for the licences to have been consistent with the Authority's statutory obligations, and to have been run effectively, transparently and on a 'level playing field', leading to a sound overall outcome which delivers value to customers.

²⁷ Chapter 2.8.8 to 2.8.11 of the Consultation.

²⁸ Chapter 1.5.10 to 1.5.16 of the Consultation.

3.0 BGE(UK) High Pressure Connected

3.1. Introduction

3.1.1 This chapter:

- a. considers the application made by BGE (UK) Limited (**BGE(UK)**) for the high pressure licence, which is connected to the application by firmus energy Limited for the low pressure licence;
- b. the responses received to the consultation on the provisional decisions, as these relate to the connected application made by BGE(UK)
- c. sets out the Authority's final conclusions as to whether BGE(UK) has met each of the criteria other than the Best Value Criterion;
- d. sets out the Authority's final assessment of the marks to be awarded to BGE(UK) in respect of the different elements of the Best Value Criterion;
- e. explains the reasons of the Authority for its final conclusions and marks.

3.1.2 In this chapter, the criteria have been addressed in the order in which they are set out in Chapter 2 of the provisional decisions, and the Authority has followed the approach to interpreting and applying the criteria that is set out in that chapter.

3.2. The Information Criterion

3.2.1 Both an electronic and a printed copy of the BGE(UK) application were received by the Authority before the deadline of noon on 6 May 2014.

3.2.2 Once the deadline had passed the application was opened and checked for completeness against a pre-prepared checklist. The application was assessed as being complete except in two respects:

- a. it was not clear from the application what information was being relied on

by BGE(UK) for the purposes of meeting the Adequate Resources Criterion; and

- b. it was not clear from the application what information was being relied on by BGE(UK) for the purposes of meeting the Financial Resources and Standing Criterion.
- 3.2.3 BGE(UK) was informed of these apparent omissions and was given until noon on 14 May 2014 to provide the missing information. A response was received by the deadline and it was subsequently judged that this addressed the omission in full²⁹.
- 3.2.4 Having considered these facts, the Authority concluded that BGE(UK) has provided all the information requested by the Authority, in such manner and by such times as was specified, and therefore meets the Information Criterion.

3.3. The Constitution Criterion

- 3.3.1 BGE(UK) is a limited company with its registered office in England. BGE(UK)'s constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations³⁰.
- 3.3.2 Having considered this evidence, the Authority was satisfied that BGE(UK) has demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.

3.4. The Fit and Proper Person Criterion

- 3.4.1 Evidence to demonstrate that BGE(UK) is a fit and proper person was provided to the Authority in accordance with paragraphs 20 to 26 of Schedule 2 to the Application Regulations³¹. It consisted of a signed statement by a senior officer of BGE(UK) to the effect that BGE(UK) had no information to disclose under any

²⁹ BGE (UK) Statement of Supporting Information for Submission to NIAUR 14-05-14

³⁰ HP Connected Schedule 2 part 1

³¹ Gas_to_the-West_Annex_2 Connected Application

of those paragraphs.

- 3.4.2 The Authority noted that BGE(UK) has no record of enforcement action being taken against it, or any other adverse factor of the type listed in the Application Regulations.
- 3.4.3 On the basis of the evidence provided to it, the Authority was therefore satisfied that BGE(UK) meets the Fit and Proper Person Criterion.

3.5. Specific Criteria – Operational Business Plan 3.17(a)

Engagement with Stakeholders

- 3.5.1 BGE(UK) stated that it has held a number of pre-meetings with stakeholders such as the Planning Service, Roads Services, and NI Environment Agency. It also listed a number of other stakeholders with whom it has developed relationships through previous projects. These included Premier Transmission Limited (PTL), Phoenix Natural Gas, firmus energy, the Northern Ireland Road Authority, the Utilities Committee of the Department of Regional Development, and the Centre for Protection of National Infrastructure³².
- 3.5.2 Landowners were identified as a key stakeholder in the pipeline construction process and BGE(UK) demonstrated in its application that it understands the importance of engagement with this key stakeholder group, has experience of such engagement, and has an appropriate plan governing its interactions with them as part of the G2W project.
- 3.5.3 BGE(UK) affirmed the importance of wayleaves and stated that it would initiate discussions with the Ulster Farmers Union and farming representatives, with whom it has existing good relationships in place having successfully completed circa 300 km of Transmission pipeline in Northern Ireland³³. BGE(UK) also set out the approach it takes with landowners should any remedial works be necessary³⁴.

³² BGE(UK), *Operational Business Plan (connected)*, section 3.6.1.

³³ Ibid, section 3.3.2.

³⁴ Ibid, section 3.6.1.

- 3.5.4 In the appendix to its OBP, BGE(UK) provided 'The Landowners Handbook' which is a guide for landowners on wayleaves, landowner and occupier agreements, the construction process and post-construction operations and maintenance.
- 3.5.5 In terms of its proposed engagement with other stakeholders which it identified BGE(UK), pointed to its partnership with firmus. It stated that this partnership provides synergies which BGE (UK) and firmus have demonstrated over the past ten years in the construction of the Northwest pipeline, South North pipeline, steel spur lines and the connection of towns along those pipelines. Examples of such synergies included the provision of a single point of contact with statutory bodies and the public, and carrying out co-ordinated public consultations.
- 3.5.6 BGE(UK) stated that both companies will engage frequently with the Department of Regional Development, MLAs and local councillors to keep elected representatives aware of the on-going works and any proposed disruption that may be incurred in their boroughs. It also stated that both companies would work closely with the Carbon Trust and Energy Saving Trust to promote energy efficiency and to endorse the positive contribution natural gas makes to the local carbon footprint³⁵.
- 3.5.7 The OBP contained a stakeholder engagement plan that was broken down into six stages, from an initial stakeholder liaison and scoping exercise to a final learning and evaluation phase³⁶. The Authority considered this a comprehensive approach and noted that it was based on previous experience both in Northern Ireland and the Republic of Ireland. It set out the relationships that BGE(UK) has already established through its existing business in Northern Ireland.
- 3.5.8 BGE(UK) stated that at the date of its application it had already held meetings with the Planning Service, Roads Services, and NI Environment Agency, and it provided proposals for public information meetings at Strabane, Enniskillen, Omagh and Dungannon.
- 3.5.9 The Authority considered that BGE(UK) had demonstrated that it has identified an appropriate range of key stakeholders, and had paid appropriate attention to

³⁵ Ibid.

³⁶ Ibid.

the key stakeholder group of landowners.

- 3.5.10 The Authority also considered that, through its stakeholder engagement plan and examples of how this has been given effect in previous projects in Northern Ireland, BGE(UK) had demonstrated that it has in place comprehensive, detailed and appropriate proposals for stakeholder engagement which were grounded in actual experience serving to establish their deliverability in practice.

Skills and experience of key members of staff and any other persons

- 3.5.11 BGE(UK) stated that it intends to rely mainly on the skills and experience of staff already employed within the BGE group and only employ an outsourcing model for certain activities³⁷.
- 3.5.12 BGE(UK)'s experience of building and operating high pressure pipelines in Northern Ireland and the Republic of Ireland³⁸ is relevant as evidence of the skills and experience of staff within the company. It has constructed 300km of high pressure pipelines in Northern Ireland and is currently in the construction management phase of a number of 70 barg pipelines in the Republic of Ireland. The majority of these projects are scheduled for completion in 2014 thus freeing up relevant staff resources³⁹.
- 3.5.13 BGE(UK) has an Asset Operations division responsible for the scheduling and completion of capital construction works⁴⁰, and it named specific key personnel, many of whom have previously worked on relevant projects in Northern Ireland, providing curricula vitae setting out their skills and experience⁴¹.
- 3.5.14 BGE(UK) stated that the resources currently deployed on high pressure pipeline projects in the Republic of Ireland can be re-deployed to the new licensed area and that BGE(UK) has already established a project management team as part of its preparations for making the licence application. In relation to the project management of construction from the initial mobilisation phase through to the

³⁷ Ibid. p. 25 and table 6 at pp. 63 – 64.

³⁸ Ibid, table 2 at pp. 37 – 38.

³⁹ Ibid. p. 20.

⁴⁰ Ibid, section 2.1.

⁴¹ Ibid, appendix A.

operation and commissioning of the pipeline, BGE(UK) stated that it can offer an end-to-end process based on its project and construction management experience of pipelines⁴².

- 3.5.15 The Authority considered that BGE(UK) had provided detailed evidence that many of the staff with the skills and experience required to carry on the licensed activities are already in place within the organisation, and that it has extensive relevant experience of undertaking similar activities. The Authority noted, and placed particular weight on the fact, that BGE(UK) has recent experience of constructing high pressure pipelines in Northern Ireland.
- 3.5.16 While it was not clear whether the named individuals whose curricula vitae were provided will necessarily constitute the senior management team which the OBP described, the Authority considered that it was clear from the evidence provided by BGE(UK) of the skills and experience within its organisation and wider group that suitable staff to fill such roles will be available to it from existing resources.
- 3.5.17 In relation to external skills and experience, the application set out the range of framework contracts which BGE(UK) already has in place and can use to access external resources where these are needed to supplement what is available within the company or wider group⁴³. These cover a range of specialist activities related to engineering services, land agency, and pipeline inspection that will be required for the new licensed area⁴⁴. The Authority considered that these were appropriate arrangements to ensure that such external resources as are needed can readily be procured.

Management of risk

- 3.5.18 BGE(UK) set out its risk management policy in section 4.1 of its OBP. This outlined how risks are identified and managed within the organisation. Section 3.7.4 of the OBP described how BGE(UK)'s approach to the management of risk will be applied to the G2W project.
- 3.5.19 Drawing on BGE(UK)'s previous experience from similar projects, the OBP also

⁴² Ibid. p. 36.

⁴³ Ibid, table 6 at pp. 63 – 64 and table 14 at p. 137.

⁴⁴ Ibid, p. 136.

set out key hazards which had been identified in each phase of the construction, commissioning and operation of the pipeline and steps that can be taken to design out or minimise these hazards⁴⁵. It provided a table summarising the likely hazards and failure mechanisms for handling gas in a high pressure transmission system, gave an indication of the likely consequence if there was a failure and included a list of the safeguards to prevent the occurrence of such events⁴⁶.

3.5.20 Sections 3.1.2.2 and 3.1.2.3 of the OBP also identified a number of high level programme (and interdependency) risks, for which some generic responses were suggested.

3.5.21 As noted above, BGE(UK) indicated that it held meetings with the Planning Service, Road Service and the NI Environment Agency. From these contacts, together with a review of the potential route for the pipeline and Fingleton McAdam Design (FMA) design, it had identified some high level programme risks specifically related to the G2W project.

3.5.22 The Authority considered that BGE(UK) had identified a number of relevant risks associated with the activities which it would be required to undertake under the licence. It has also provided evidence that it has robust systems in place to deal with such risks, and to identify others, and has presented suggestions for the avoidance and mitigation of the risks that it has identified thus far.

3.5.23 This view was supported by the advice received from Rune⁴⁷.

Tendering arrangements

3.5.24 In its OBP, BGE(UK) set out detailed information in relation to its tendering arrangements, which the Authority considered demonstrated an understanding of best practice in this regard.

3.5.25 BGE(UK) stated that its project team will include a Contract Manager with responsibility for contract strategy, negotiation and management and that its existing support services will provide procurement support for the contract

⁴⁵ Ibid, sections 4.1.2 to 4.1.2.4.

⁴⁶ Ibid, sections 4.1.3 to 4.1.5.

⁴⁷ RUNE Associates, *Gas to the West: Technical Advice on High Pressure Submissions*, 19 June 2014, p. 2.

arrangements⁴⁸.

- 3.5.26 Policies and procedures to ensure compliance with EU procurement regulations were described and financial thresholds for advertisement in the EU Journal were specified. Competitive tendering and evaluation scoring processes were also described in general terms⁴⁹.
- 3.5.27 BGE(UK) stated that it will utilise its current process for contract lifecycle and contract risk management and provided summary details of that process. It also provided information regarding the arrangements it has in place to establish framework contracts where it is likely to have repeated tendering needs, and outlined details of existing contracts of this type that can be utilised for various specialist services⁵⁰. Summary details of 17 strategic framework contracts that are relevant to the G2W project were included⁵¹.
- 3.5.28 BGE(UK) outlined its strategy for procuring materials and indicated that this strategy would be used for the G2W project. It also stated its intention to utilise its existing framework agreements to procure materials associated with the construction of the pipeline where applicable⁵².
- 3.5.29 These agreements cover a range of materials, including pipe, and BGE(UK) stated that they provide benefits in terms of delivery lead time and bulk purchasing power. Provisional arrangements for on-site storage of pipe had already been investigated by BGE(UK) and were also described⁵³.
- 3.5.30 The OBP provided details of the options available for the award of construction contracts based on whether or not the contracting entity is a Northern Ireland company (and thus whether or not EU procurement law requirements apply)⁵⁴. It also stated that maintenance contracts which BGE(UK) already has in place in Northern Ireland require only minor amendments to cover the G2W project⁵⁵.
- 3.5.31 Finally, BGE(UK) stated that it will use framework contracts already in place in

⁴⁸ Ibid, section 3.1, Fig 4.

⁴⁹ Ibid, section 6.1.

⁵⁰ Ibid, section 6.1.1.1.

⁵¹ Ibid, section 6.1.1.

⁵² Ibid, section 6.2.

⁵³ Ibid.

⁵⁴ Ibid, section 6.3.1.

⁵⁵ Ibid, section 6.3.2.

relation to a variety of specialist services⁵⁶.

3.5.32 Overall, the Authority considered that BGE(UK) had provided clear and detailed information regarding its proposals as to the use of tendering arrangements and that those arrangements were robust and in line with best practice. The Authority noted in particular that BGE(UK) will be able to utilise a number of framework contracts which it already has in place in relation to materials and specialist services.

3.5.33 The Authority attached weight to the fact that these arrangements had been proven effective through their use in previous projects, and to the thought that had been given already by BGE(UK) to their suitability for the G2W project.

3.5.34 This view was supported by the advice received from Rune⁵⁷.

Final mark for sub-criterion 3.17(a)

3.5.35 In arriving at its final score for sub-criterion 3.17(a) the Authority considered the response made by BGE(UK) to the provisional decisions. BGE(UK) stated that it did not believe that its scoring in relation to the Operational Business Plan, when viewed relative to that of other applicants, fully reflected the strength of its application, in particular its experience in the management of high pressure pipelines.

3.5.36 The Authority reviewed its scoring against the relevant Criteria for the purpose of reaching its final conclusions. In doing so, it noted BGE(UK)'s comments, but in the absence of any more particularised challenge to the provisional marks did not consider that there was any ground for changing those marks. See chapter 2 for further details.

3.5.37 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the BGE(UK) application should attract a high score, and its final decision is to award 18 out of 20 marks, in relation to sub-criterion 3.17(a).

⁵⁶ Ibid, section 6.3.3.

⁵⁷ RUNE Associates, *Gas to the West: Technical Advice on High Pressure Submissions*, 19 June 2014, pp. 4 – 5.

- 3.5.38 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.
- 3.5.39 When compared with the other applications, the Authority considered that the BGE(UK) application provided a comprehensive and well-evidenced statement of how it would carry out activities under the licence. It presented evidence of strong skills and experience in relation to high pressure networks (both their operation and construction), adequately reflected in its plans in relation to the G2W project. It could be distinguished from the much weaker PNGL application on this basis. NIEH submitted an application that also evidenced good skills and experience and was much closer to that of BGE(UK), but BGE(UK) was slightly stronger in its ability to draw on recent experience of building high pressure pipelines in Northern Ireland and reflect that experience in forward plans, such as its good and detailed proposals for engagement with landowners.

3.6. Specific Criteria – Operational Business Plan 3.17(b)

- 3.6.1 Table 3.1 below sets out the values for each of the cost items submitted by BGE(UK) in its application⁵⁸.
- 3.6.2 These figures cover all the relevant data that were provided by BGE(UK) and therefore carried out its assessment for the purposes of sub-criterion 3.17(b) against BGE(UK)'s description of its derivation of those data.
- 3.6.3 The Authority divided the costs into two broad categories of Weighted Average Cost of Capital (WACC) and Capital Expenditure. The Capital Expenditure category consisted of four separate cost lines: Design/Project Management, Contingency, Mobilisation and Other Applicant Costs. These cost lines are consistent with what the Authority stated applicants should supply in the Data Input Workbook⁵⁹.

⁵⁸ BGE (UK) Connected High Pressure Data Input Workbook.

⁵⁹ To assist the applicants the Authority also provided some detail on each cost area in the Application Information Pack

Table: 3.1 BGE (UK) Connected High Pressure Data Input Workbook Cost Items

Cost Item	Value
Weighted Average Cost of Capital	6.19%
Design / Project Management	£11.942m
Contingency	£4.328m
Mobilisation	£0.300m
Other Applicant Costs	£0.000m

Description of the derivation of cost data

Weighted Average Cost of Capital

3.6.4 NERA was requested to produce a report on what it would expect to see in a well-evidenced WACC submission. The Authority substantially agreed with the assessment reflected in that report. It follows the Authority would have expected to see:

- a. The cost of debt set out using:
 - (i) a benchmark gilt yield (to reflect a risk free rate) plus evidence on corporate debt spreads with market evidence provided for both; and/or,
 - (ii) direct evidence of corporate debt yields with market evidence provided. For this purpose, references to corporate debt spreads/yields should reflect companies with similar risk profiles, issuance costs should be included in the cost of debt and the treatment of inflation should be clearly explained in the derivation.
- b. The cost of equity set out using Capital Asset Pricing Model (CAPM) and incorporating the risk free rate, equity risk premium and beta with relevant evidence provided to justify each component.

- c. The proposed gearing including a discussion on the how this interacts with the risks of the project, the proposed credit rating and the cost of debt.
- 3.6.5 BGE(UK)'s application was based on a standard debt/equity capital structure and included proposals for both debt and equity costs.
- 3.6.6 The Authority considered that the application gave a reasonable but incomplete description of how the cost of capital figure in the Data Input Workbook was built up⁶⁰.
- 3.6.7 Table 18 provided a clear presentation of the components used to calculate the proposed WACC. For cost of debt a figure of 3% was proposed. It was stated that this was taken from a range of possible values derived by establishing the upper and lower bounds of possible values. The lower bound was derived from the iBoxx index and the upper bound figure was taken from the Utility Regulator determination on the BGE(UK) price control in October 2012⁶¹. The application also clearly set out how it had accounted for inflation and transaction costs⁶².
- 3.6.8 The Authority considered the explanation of the upper and lower bounds to be in line with reasonable expectations, and well-evidenced with a reasonable amount of clarity provided. The Authority also regarded the use of regulatory precedents in explaining the inflation and transaction cost figures to be of assistance in understanding the derivation of the data.
- 3.6.9 However, the actual lower bound figure was not stated and there was very limited explanation of how the final figure for the cost of debt was arrived at. This demonstrated some lack of clarity in the application.
- 3.6.10 To estimate the cost of equity, CAPM had been applied and a figure of 12.44% was proposed. There was a useful discussion of the estimates of the Total Market Return to Equity⁶³, the Risk Free Rate and the Equity Risk Premium values with clear reference made to recent regulatory determinations, together with an explanation of why BGE(UK) preferred to rely on Ofgem's methodology of Revenue = Incentives + Innovations + Outputs (RIIO-T1) and RIIO-GD1 when

⁶⁰ BGE (UK) Connected Gas to the West Operational Business Plan – Chapter 10.

⁶¹ BGE((NI) Ltd. Price Control 2012-2017 Determination, para. 6.23, p.28,

⁶² BGE (UK) Connected Gas to the West Operational Business Plan p.178

⁶³ The Total Market Return to Equity is the sum of the risk free rate plus the equity risk premium.

arriving at a final figure than on the Competition Commission's determination in the recent Northern Ireland Electricity Case.

- 3.6.11 In estimating the beta values, the application referenced Table 19, describing different types of comparator companies and sectors which BGE(UK) stated that it had considered in arriving at those values.
- 3.6.12 The Authority considered the explanation of the Total Market Return to Equity, Risk Free Rate and Equity Risk Premium to be good and the reliance on recent regulatory precedents to be well-evidenced. However, the derivation of the final figure could have benefited from more detailed explanation.
- 3.6.13 Beta figures were not provided in Table 19 and it was unclear to the Authority what the proposed range was or how the final figure for asset beta values was arrived at. The application in this respect was simply not complete.
- 3.6.14 The Authority also noted that the 2% upper estimate for the risk free rate used in the cost of debt section⁶⁴ appeared to be inconsistent with the 1.5% figure used in the equity section⁶⁵ and regarded this inconsistency as weakening the quality of the evidence provided in the application.
- 3.6.15 NERA also found that, taken in the round, BGE(UK)'s description of how it had derived its cost of debt was well-evidenced, but that there was no explanation of the determination of the final figures proposed⁶⁶.
- 3.6.16 While NERA advised that the cost of equity component was well-evidenced⁶⁷, the Authority considered that the evidence provided was incomplete (e.g. asset beta data) and inconsistent in places (e.g. risk free rate) and to that extent was not as clear or full a description as it would have expected.

Capital Expenditure

- 3.6.17 BGE(UK) provided an explanation of some of its cost items but not others. No spreadsheet was provided to allow a detailed analysis of all the figures.

⁶⁴ BGE (UK) Connected Gas to the West Operational Business Plan, p. 178

⁶⁵ BGE (UK) Connected Gas to the West Operational Business Plan, p. 179

⁶⁶ NERA, Gas to the West, A Report for the Utility Regulator, Section 2.2.2 p. 6.

⁶⁷ NERA, Gas to the West, A Report for the Utility Regulator, Section 3.2.1 p. 12.

- 3.6.18 The Design and Project management and Mobilisation values in the Data Input Workbook were calculated using a function of Maximo, the asset management system, known as Compatible Units⁶⁸. This records costs from previous projects and converts them into comparable units. Values were therefore based on experience of previous projects and the G2W high pressure network design produced by Fingleton McAdam. There was also some additional breakdown of the costs provided in Table 16, e.g. Design and Planning, but no spreadsheet was provided with any detailed explanation.
- 3.6.19 There was no explanation given for the contingency figure.
- 3.6.20 While the Authority considered the use of Maximo to be a robust approach, there were only high level final figures presented in the application and no detail as to how the values in the Data Input Workbook were derived. Given the use of a building block system to calculate the figures, the Authority would have expected a detailed discussion of the various elements used to derive the final figure.
- 3.6.21 This deficiency was demonstrated by the fact that there were different figures inserted in Table 16 for Project Management in this (the BGE(UK) connected⁶⁹) application and in the BGE(UK) unconnected⁷⁰ application. There was no self-evident reason for the difference, and in the Authority's opinion, in an adequately explained submission it would have been possible to ascertain if there was a reason behind this difference or if it was just an error.
- 3.6.22 The Authority also noted that, since the activities included in Mobilisation are specific to the G2W project and relate to establishing commercial arrangements to convey gas across the pipeline, a more tailored approach to calculating this figure would have been appropriate.
- 3.6.23 The Authority also noted and had regard to the fact that the Mobilisation value of £0.300m appeared to have been double counted. BGE(UK)'s Table 16 described the Design/Project Management figure of £11.942m which was included in the

⁶⁸ BGE (UK) Connected Gas to the West Operational Business Plan – Section 3.4 and 9.2.

⁶⁹ BGE(UK) Connected Gas to the West Operational Business Plan, p.171.

⁷⁰ BGE(UK) Connected Gas to the West Operational Business Plan, p.162.

Data Input Workbook⁷¹. The table clearly included £0.300m mobilisation costs in this overall figure. However, the Data Input Workbook also included a separate and additional amount for mobilisation of £0.300m.

- 3.6.24 As there was no explanation provided for the contingency figure, the Authority considered this part of the information provided to be incomplete.

Identification and application of cost drivers

- 3.6.25 BGE(UK) used a compatible unit estimate approach to build up the activities for the G2W project based on its pipeline construction experience. While BGE(UK) provided Table 16, there was a very limited breakdown of the costs provided in this table.⁷²

- 3.6.26 The Authority considered that it was not possible to ascertain from this what cost drivers had been used to build up costs, and the evidence provided in relation to cost drivers had therefore to be assessed as weak.

Robustness of assumptions

- 3.6.27 The Authority identified and considered a number of assumptions that appeared to have been made by BGE(UK) when deriving the data contained in its Data Input Workbook.

The Value of the WACC

- 3.6.28 First, the Authority took it to be implicit throughout the application that BGE(UK) had assumed it will be able to carry on the licensed activities under the high pressure licence, and to do so consistently with its obligations under that licence, on the basis of the proposed WACC. That is to say, there was an implicit assumption that BGE(UK) will be able to raise the finance required to construct and operate the high pressure network while subject to a revenue control condition embodying its proposed WACC.
- 3.6.29 For the purpose of testing this assumption, the Authority considered whether the proposed WACC fell within the range of what might reasonably be expected in

⁷¹ Data Input Workbook Design & Project Management £11.942m Mobilisation £0.300 m - BGE(UK) Connected Gas to the West Operational Business Plan – Table 16 Project Management + Design % Planning £11.642m Mobilisation £0.300m.

⁷² BGE(UK) Connected Gas to the West Operational Business Plan, p.171.

the context of the G2W project. To do this, it considered the market cost of debt and equity based on advice received from NERA, which took into account in its report such costs as referenced in recent regulatory decisions⁷³. NERA advised on what it considered to be the 'plausible range' within which it would expect any WACC for this project to lie. The Authority relied upon the advice contained in the report as establishing a range against which to test BGE(UK)'s assumption

- 3.6.30 NERA established a 'plausible range' in respect of a debt/equity model of 3.5% - 6.2%⁷⁴, and BGE(UK)'s proposed WACC was 6.09%.
- 3.6.31 The Authority noted that the proposed BGE (UK) WACC lay at the high end of, but fell within, the range identified by NERA.
- 3.6.32 In addition BGE(UK) identified its ability and intention to finance the project through corporate finance, and referenced its 2012 financial statements and its access to finance facilities⁷⁵. It stated that it had already received the approval of its Board of Directors, so that financial resources were available to complete the project⁷⁶. In addition it provided historical evidence that it had raised finance for construction of high pressure pipelines in Northern Ireland⁷⁷.
- 3.6.33 Having regard to its own expertise, the Authority considered that the proposed WACC was high and therefore reflective of a cost of debt and equity that would attract investors. Given that the WACC also lay within NERA's plausible range, and that the proposal was in any event to fund the project on a corporate finance basis, with evidence of a board level approval already in place, the Authority had no concerns about the ability of BGE(UK) to finance its activities under the high pressure licence on the basis of the proposed WACC.
- 3.6.34 Therefore the Authority concluded that the assumption that BGE(UK) would be able to obtain financing to carry on the licensed activities on the basis of the proposed WACC was robust.

⁷³ NERA, Gas to the West, A report for the Utility Regulator

⁷⁴ NERA p. 33

⁷⁵ BGE (UK) Annex 3 Form of Application p9

⁷⁶ BGE (UK) Responses to Email from Utility Regulator, 9th May 2014

⁷⁷ BGE (UK) Annex 3 Form of Application p9

Transaction Costs

- 3.6.35 Second, the BGE(UK) proposed WACC included an adjustment of 0.2-0.3% for transaction costs associated with raising finance. This was based on regulatory precedent, including the recent Competition Commission determination relating to Northern Ireland Electricity.
- 3.6.36 The Authority considered this assumption to be robust in light of the explanation given in support of it, and could identify no reason why the references cited by BGE(UK) would not be of relevance to the G2W project.

Gearing

- 3.6.37 Third, BGE(UK) proposed⁷⁸ a gearing ratio of 75% based on a survey of gearing ratios of utilities in the United Kingdom. There was no discussion as to whether or not this level of gearing would be appropriate, given the level of project risk assumed elsewhere in the application.
- 3.6.38 NERA advised that the assumptions relating to gearing could not be considered as robust due to a lack of evidence in support of them⁷⁹. The Authority also concluded that the application provided incomplete evidence in this regard and agreed with the NERA advice.

Asset Beta

- 3.6.39 Fourth, the asset beta section of the application⁸⁰ includes assumptions relating to ground conditions and construction risk and how they should impact on betas. However, no detailed evidence was provided as to why the level of risk might compare with United States Construction or Renewable Generation.
- 3.6.40 The Authority would have expected to be provided with examples of similar gas transmission assets regulated in such a manner elsewhere, particularly as BGE(UK) notes previous experience with poor ground⁸¹.
- 3.6.41 In addition the Authority noted that no reference was made to calculations which other regulators have used in determining how companies with different levels of

⁷⁸ BGE (UK) Connected Gas to the West Operational Business Plan, p. 180

⁷⁹ NERA 4.2.1 p. 16.

⁸⁰ BGE (UK) Connected Gas to the West Operational Business Plan, p. 178

⁸¹ BGE (UK) Connected Gas to the West Operational Business Plan – p. 71

construction risk might require different beta figures e.g. Ofgem RIIO - GD1.

3.6.42 The Authority had questioned similar arguments previously⁸² and BGE(UK) provided no additional evidence in support of them. In principle, the Authority was not convinced that project specific risk, e.g. as to ground conditions, should impact on beta values which are intended to measure the impact of market wide systematic risk on the investment in question when measured against the impact on the market as a whole. BGE(UK)'s application failed to address this issue.

3.6.43 The Authority was therefore unable to regard BGE(UK)'s assumptions in relation to the impact of such risk on betas as being robust.

Duration of the WACC

3.6.44 Fifth, the Authority noted the statement made by BGE(UK) that the WACC must be allowed throughout the project lifetime⁸³. This statement is inconsistent with the Authority's clearly expressed position as outlined in the Applicant Information Pack⁸⁴. To the extent that BGE(UK)'s application is premised on an assumed unchangeable WACC, that assumption is not robust.

Capital Expenditure

3.6.45 Sixth, BGE(UK)'s calculation of capital expenditure costs used Maximo and they were built up from other gas high pressure construction projects. This assumed that the pipeline will have a similar cost structure to other high pressure pipelines on the island of Ireland.

3.6.46 The Authority recognised this as a robust assumption in most cases. However, as noted above, the Authority considered that mobilisation costs may not suit such a generic approach given the very specific costs included within this overall cost line. To that extent a caveat must be attached to the assumption.

Final Conclusion

3.6.47 The Authority regarded some of the assumptions relied upon by BGE(UK) as robust in the light of the explanation and evidence provided in support of them,

⁸² [Utility Regulator, Gas Network Extensions in NI: Approach to comparing HP licence Applications, 6 Feb, p. 7]

⁸³ BGE (UK) Connected Gas to the West Operational Business Plan, p. 177

⁸⁴ Applicant Information Pack, paragraph 3.27 – 3.30

but others not to be robust for the reasons set out above.

Evidence verifiable from its previous experience

3.6.48 The BGE(UK) application used Maximo and the Component Unit cost approach, based on evidence gained from its own experience of developing high pressure pipelines in a similar context to the G2W project.

3.6.49 The Authority regarded this as a robust use of previous experience.

Identification and quantification of risk

3.6.50 The BGE(UK) application specifically referenced the risk of deviations between spot estimates of the cost of debt and longer term trends⁸⁵. It recognised that the cost of debt proposed in the application may be different from the cost of debt that can be raised in the future if markets change significantly. However, there was no discussion of the quantification of this risk.

3.6.51 There was also reference in the application⁸⁶ to risks relating to issues with the route and location of the pipeline. Again, BGE(UK) provided no quantification of these risks nor any suggestion as to approaches that might be taken towards their mitigation.

3.6.52 The Authority considered that both of the risks noted above were appropriately identified, but neither of them was quantified in terms of probability or impact.

3.6.53 Overall the Authority considered the identification and quantification of risk to be limited. The Authority would have expected the application to directly address the risks of each cost line with consideration given to the likelihood and impact of the risks and some discussion on possible mitigation measures in each case.

Efficiency improvement plan

3.6.54 Some evidence of past efficiency improvement was presented, e.g. the Networks Transformation Programme. There was reference⁸⁷ to using Maximo to reduce

⁸⁵ BGE (UK) Connected Gas to the West Operational Business Plan – p. 178.

⁸⁶ BGE (UK) Connected Gas to the West Operational Business Plan – p. 153

⁸⁷ BGE (UK) Connected Gas to the West Operational Business Plan – p. 101

costs, as well as general approaches to cost management⁸⁸, and a discussion of benchmarking⁸⁹ and how it is used to drive continuous improvement. This latter discussion included reference to examples that had resulted in efficiencies and which could be applied in Northern Ireland. BGE(UK) also provided information on design optimisation and highlighted potential benefits including increased capacity and reducing distribution costs.

3.6.55 The Authority therefore considered that there was some evidence of efficiency improvement in the application. However, some of the examples given represent no more than good practice (e.g. using efficient boilers) and no quantification of benefits attaching to them was given.

3.6.56 In the absence of an explicit efficiency improvement plan, and given the limited value of the examples of past efficiency improvement provided, the Authority considered that this element of the application was very weak, with no evidence presented of specific plans or programmes to improve the efficiency of operation of a high pressure pipeline.

Final mark for sub-criterion 3.17(b)

3.6.57 Having regard to the OBP and in particular to the matters identified above, the Authority considered that the BGE(UK) application should attract a low score, and its final decision is to award 9 out of 20 marks, in relation to sub-criterion 3.17(b).

3.6.58 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.

3.6.59 When compared with the other applications, the Authority considered that the BGE(UK) application was inconsistent in quality. The information and evidence presented in support of the WACC was reasonable overall; the methodology was sound and the data sources used were generally reliable. However, there were areas in which it could have been fuller and more detailed. This part of the application was good in comparison to PNGL, but less clear and comprehensive

⁸⁸ BGE (UK) Connected Gas to the West Operational Business Plan – p. 153

⁸⁹ BGE (UK) Connected Gas to the West Operational Business Plan – p. 162

than NIEH Ltd. In relation to capital expenditure the application was weak, with limited detail and at least one apparent error. The overall mark reflected the medium quality of the WACC analysis adjusted by the clearly low quality description relating to capital expenditure.

3.7. Specific Criteria – Operational Business Plan 3.17(c)

The experience of the applicant and others on whom it intends to rely in relation to network construction

- 3.7.1 BGE(UK) stated that it intends to rely on experience from within the BGE group, including its own subsidiary Bord Gais Networks, in the construction of the high pressure network, and only employ an outsourcing model for certain activities⁹⁰.
- 3.7.2 The OBP contained details of previous experience within the BGE group of building and operating high pressure pipelines in both Northern Ireland and the Republic of Ireland⁹¹. BGE(UK) itself has constructed 300km of high pressure pipelines in Northern Ireland and is currently in the construction management phase of a number of 70 barg pipelines in the Republic of Ireland. BGE(UK) stated that these pipelines have been constructed within programme time and budget⁹².
- 3.7.3 The Authority noted that BGE(UK) is a subsidiary of BGE, which owns and operates the high pressure gas network in the Republic of Ireland. This consists of over 2,400km of high pressure (>19bar) pipelines including around 400 km of subsea interconnectors to Scotland.⁹³
- 3.7.4 BGE(UK) indicated that it would avail of the construction experience elsewhere within BGE for the project⁹⁴. The Authority considered this to be a reasonable and credible proposal.
- 3.7.5 Overall, the Authority considered that BGE(UK) had demonstrated a significant degree of relevant experience, both from within its own resources and those of

⁹⁰ Ibid. p. 25 and table 6 at pp. 63 – 64.

⁹¹ Ibid, table 2 at pp. 37 – 38.

⁹² Ibid, p.29.

⁹³ Ibid, p.25.

⁹⁴ Ibid, p23.

its wider group, on which it will be able to draw in relation to managing the processes and resources necessary to construct a high pressure network.

- 3.7.6 The Authority also noted that BGE(UK) has in place a number of framework agreements which cover services relevant to network construction, such as engineering services and land agency. The Authority cannot directly assess the skills and experience of the bodies with which BGE(UK) has such arrangements. However, it considered that the internal experience upon which BGE(UK) can draw in relation to the construction of high pressure networks indicates that such arrangements, managed by experienced internal staff, are an appropriate means of supplementing that experience where necessary.

The experience of the applicant and others on whom it intends to rely in relation to network construction

- 3.7.7 BGE(UK) provided information in its OBP with regard both to its own experience of high pressure network operation and to that within the wider BGE group.
- 3.7.8 In Northern Ireland, BGE(UK) operates the North West Pipeline which takes the form of a 450mm pipeline which became operational in 2004, extending 112km from Carrickfergus to supply the power station at Coolkeeragh. It also operates the South-North Pipeline which became operational in 2006 and is a 156km long pipeline extending from the landfall of the gas interconnector at Gormanston, Co. Meath, in the Republic of Ireland to Ballyalbanagh on the North West Pipeline⁹⁵.
- 3.7.9 BGE(UK) referred to what it described as an exemplary safety record in high pressure pipeline construction and operation resulting from its competence, capability, and experience in the industry⁹⁶.
- 3.7.10 The OBP indicated that BGE(UK) has an existing central control room operation and drew attention to its management of the gas supply and demand on the current Northern Ireland pipeline network during the record winter cold weather periods experienced in 2009/2010. BGE(UK) stated that during this period no interruptions in gas supplies were experienced by Northern Ireland customers and record gas flows were transported through the Beattock Compressor

⁹⁵ Ibid, p. 21.

⁹⁶ Ibid, p. 23.

Station. It asserted that this indicates that the control room will be capable of monitoring and supervising the high pressure pipeline which is the subject of the licence.

- 3.7.11 The OBP stated that installations on the high pressure pipeline will be monitored via remote telemetry at BGE(UK)'s Grid Control Centre, where any deviation from the standard operating parameters may be detected and result in a call out of the local BGE(UK) operations personnel. It proceeded to provide details of BGE(UK)'s existing SCADA⁹⁷ system.
- 3.7.12 In addition to SCADA, BGE(UK) provided information to illustrate that it has other IT systems necessary to operate the network; these include GTMSNI⁹⁸, asset management and cathodic protection remote monitoring systems⁹⁹. BGE(UK) stated that the new licensed area will leverage off these existing systems¹⁰⁰, and that it has contracts in place for maintenance services which can, with minor amendments, be extended to cover the new licenced area¹⁰¹.
- 3.7.13 The OBP indicated that BGE(UK) assumes it will be operating its existing high pressure networks under the single Northern Ireland network code. BGE(UK) is already a party to the Northern Ireland Network Operators Agreement, which it assumes would be a requirement for the holder of the licence.
- 3.7.14 BGE(UK) stated that, in carrying out its current network operation in Northern Ireland, it utilises the services of both Bord Gais Networks and BGE group and that BGE(UK) similarly proposes to rely on the services of Bord Gais Networks to deliver the G2W project¹⁰².
- 3.7.15 The OBP contained further information on Bord Gais Networks' experience of high pressure network operation in the Republic of Ireland¹⁰³.
- 3.7.16 Overall, the Authority considered that BGE(UK) had provided comprehensive and detailed information, with appropriate supporting evidence, to demonstrate

⁹⁷ Supervisory Control and Data Acquisition.

⁹⁸ The Gas Transportation Management System Northern Ireland provides functionality for capacity booking, shippers, nominations, allocations, balancing, scheduling, shrinkage and billing.

⁹⁹ BGE(UK), op cit, p.52.

¹⁰⁰ Ibid.

¹⁰¹ Ibid, section 6.3.2.

¹⁰² Ibid, p. 25.

¹⁰³ Ibid, p. 29

its own experience in operating high pressure networks and the experience of the wider group on which it is able to draw.

3.7.17 This conclusion was supported by the advice received from Rune¹⁰⁴.

Securing, mobilisation and management of resources

3.7.18 BGE(UK) provided detailed proposals in relation to how it would seek to secure, mobilise and manage the internal and external resources necessary for the construction of the network.

3.7.19 As noted above, in relation to internal resources, BGE(UK) indicated that it intends to rely on the services of its subsidiary Bord Gais Networks to deliver the project. Resources for construction would be sourced via the BGE group.

3.7.20 In relation to external resources for the construction of the network, BGE(UK) stated that, if EU procurement requirements do not apply, it will use its existing pre-approved suppliers. Otherwise it stated that BGE(UK) and BGE have many of the contracts needed currently in place; for example, BGE(UK) would utilise its existing framework agreements for materials¹⁰⁵ and strategic contracts under its framework agreements in relation to engineering works and services¹⁰⁶ and for specialist services¹⁰⁷.

3.7.21 BGE(UK) stated that an Executive Steering Group led by the BGE(UK) chairman has been established for the G2W project and an initial team had undertaken consultation with key stakeholders including firmus Energy¹⁰⁸. BGE(UK) stated that, drawing on past experience, it intends to establish a project team which will be similar to the project team that delivered the North West, South-North and Kernan to Derryhale pipelines¹⁰⁹.

3.7.22 BGE(UK) proposed that a single project team will be established with firmus, an approach that has proved successful in the past. Detailed information was provided regarding what BGE(UK) claimed would be the potential areas of

¹⁰⁴ RUNE Associates, op cit, p.7.

¹⁰⁵ BGE(UK), op cit, p.138.

¹⁰⁶ Ibid, p.141.

¹⁰⁷ Ibid, p.143.

¹⁰⁸ Ibid, p. 29.

¹⁰⁹ Ibid.

significant benefit arising from this arrangement, for both the high pressure and low pressure networks, in terms of delivery and costs¹¹⁰.

3.7.23 Organisational arrangements for the project team were described in the OBP with roles clearly indicated¹¹¹. BGE group functional support was also identified¹¹² as were key personnel¹¹³.

3.7.24 BGE(UK) also provided information on its existing range of information systems which were developed to support the construction, operation and maintenance of other high pressure networks. It stated that it is intended that these systems will be utilised in relation to the high pressure network; BGE(UK) and Bord Gais Networks already having existing systems in place such as Maximo and GTMS. These are used in the Republic of Ireland and Northern Ireland and BGE(UK) stated that it does not envisage the need for any new systems¹¹⁴.

3.7.25 Overall, the Authority considered that BGE(UK) had provided comprehensive and detailed information, with appropriate supporting evidence, to demonstrate the appropriateness of its proposals to secure, mobilise and manage the internal and external resources necessary to construct the network.

3.7.26 This conclusion was supported by the advice received from Rune¹¹⁵.

Engagement with stakeholders

3.7.27 As noted above, the Authority considers there to be substantial overlap between sub-paragraphs 3.17(a)(i) and 3.19(g) of the Criteria. The Authority's analysis of BGE(UK)'s application under sub-paragraph 3.17(a)(i) is therefore of relevance and is adopted as part of its assessment here.

3.7.28 BGE(UK) provided a comprehensive stakeholder engagement plan broken down into six stages from an initial stakeholder liaison and scoping exercise to a final learning and evaluation phase¹¹⁶. The plan was based on previous experience, in Northern Ireland and the Republic of Ireland, and set out the relationships that

¹¹⁰ Ibid.

¹¹¹ Ibid, p. 34.

¹¹² Ibid. p. 47.

¹¹³ Ibid, appendix A.

¹¹⁴ Ibid, p. 52.

¹¹⁵ RUNE Associates, op cit, p.9 and pp. 13-14.

¹¹⁶ Ibid.

BGE(UK) has already established through its existing business in Northern Ireland.

- 3.7.29 As noted in Chapter 2 of the provisional decisions, sub-paragraph 3.19(g) contains a degree of specificity which is not contained in sub-paragraph 3.17(a)(i), as it refers to proposals in relation to particular groups of stakeholders which the latter does not. Those groups are identified as 'all relevant regulatory authorities and statutory agencies, other licence holders and private entities necessary to construct a high pressure network'.
- 3.7.30 With regard to relevant regulatory authorities and statutory agencies, BGE(UK) listed previous relationships with the Northern Ireland Road Authority, the Utilities Committee of the Department of Regional Development, and the Centre for Protection of National Infrastructure¹¹⁷, and stated that it will engage frequently with Department of Regional Development¹¹⁸. It also stated that it has already held meetings with the Environment Agency.¹¹⁹
- 3.7.31 The Authority considered that BGE(UK) has demonstrated an appreciation of the relevant regulatory authorities and statutory agencies which would be involved in the construction of the network. When therefore it states later in its OBP that, as part of its stakeholder engagement plan, it will liaise with statutory bodies the Authority had confidence that it has a clear understanding of who the relevant bodies are.
- 3.7.32 BGE(UK) has also demonstrated its consideration of other licence holders through its reference to its existing relationships with other licence holders such as Premier Transmission Limited (PTL), Phoenix Natural Gas, firmus energy¹²⁰.
- 3.7.33 As explained above, the Authority considers landowners to be the key private stakeholder in regard to the construction of the high pressure network. BGE(UK) demonstrated that it understands the particular importance of engagement with landowners, has experience of such engagement, and has a plan for interactions with them. One example of the way in which this is signalled in its application

¹¹⁷ Ibid, section 3.6.1.

¹¹⁸ Ibid.

¹¹⁹ Ibid.

¹²⁰ Ibid.

was through the inclusion of its 'Landowners Handbook'¹²¹.

- 3.7.34 Overall, the Authority considered that, through its stakeholder engagement plan and examples of previous relevant experience of stakeholder engagement in Northern Ireland, BGE(UK) had demonstrated that it has established plans for stakeholder engagement that are comprehensive, detailed and appropriate.

Timely delivery of the high pressure network

- 3.7.35 In section 3.1 of its OBP, BGE(UK) outlined detailed proposals for the timely delivery of the high pressure network based on its previous experience in undertaking the construction of other similar networks. In appendix B, BGE(UK) also provided detailed project plan diagrams which included estimated durations for more than 110 discrete activities as part of the construction project. The OBP additionally provides detailed information defining the planned activities.
- 3.7.36 Although BGE(UK) provided a project plan based on a three year timescale for network delivery, it stated that based on its experience a timescale of four years may be more appropriate¹²² and so provided project plan diagrams on that basis. However, the Authority noted that the advice from Rune concludes that the proposed programme for completion within three years is inherently credible¹²³.
- 3.7.37 The Authority noted that the BGE(UK) plan¹²⁴ indicated a start date in 2015 despite the Authority stating that the licence was proposed to be awarded in October 2014¹²⁵. The reason for this proposed delay following the award of the licence was not explained, and it was unclear whether it reflected an assumption by BGE(UK) that the timetable for licence grant was likely to change, or whether it represented a window that BGE(UK) wished to have between licence grant and the commencement of activities. If the latter, the Authority considered that it could involve an unnecessary period without activity, with consequential effects on the overall delivery of the plan. However, it did not regard this issue as having material weight in its overall assessment.

¹²¹ Ibid, Appendix C.

¹²² Ibid, section 3.1.1.

¹²³ RUNE Associates, op cit, p.17.

¹²⁴ [Ibid, Appendix B,]

¹²⁵ Paragraph 4.48 of the Applicant Information Pack.

- 3.7.38 BGE(UK) provided information as to how it proposes to manage risk as part of the project. The Authority recognised that this is an important aspect of timely delivery. BGE(UK)'s management of risk is discussed above under sub-criterion 3.17(a), and the Authority's conclusion that the approach to risk described was robust is relevant and adopted here.
- 3.7.39 In its assessment of the matters arising under this heading the Authority also had regard to BGE(UK)'s proposal to substitute high pressure pipelines with low pressure pipelines. The report from Rune advised that this proposal was credible but that no evidence was provided of a high level cost benefit analysis. Rune also concluded that the twelve bar minimum pressure option had not been well-explained and Rune could not view it as credible¹²⁶. The Authority concluded that this proposal would not have a material impact on the timely delivery of the pipeline in light of the other detailed evidence provided by BGE(UK).
- 3.7.40 Overall, the Authority concluded that BGE(UK) can draw upon very significant experience in the construction of high pressure pipelines and therefore has a clear understanding of the activities involved in delivering such projects. The Authority considered that BGE(UK)'s proposed programme for construction and commissioning of the pipeline over a three year period was credible on the basis of both previous experience and the detailed explanation of its project plan provided in the application.
- 3.7.41 This conclusion was supported by the advice provided by Rune.¹²⁷

Final mark for sub-criterion 3.17(c)

- 3.7.42 In arriving at its final score for 3.17(c) the Authority considered the response made by BGE(UK) to the provisional decisions. BGE(UK) stated that it did not believe that its scoring in relation to the Operational Business Plan, when viewed relative to that of other applicants, fully reflected the strength of its application, in particular its experience in the management of high pressure pipelines.
- 3.7.43 The Authority reviewed its scoring against the relevant Criteria for the purpose of reaching its final conclusions. In doing so, it noted BGE(UK)'s comments, but in

¹²⁶ Ibid, p.14.

¹²⁷ Ibid, p. 17.

the absence of any more particularised challenge to the provisional marks did not consider that there was any ground for changing those marks. See chapter 2 for more details.

- 3.7.44 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the BGE(UK) application should attract a medium score, and its final decision is to award 15 out of 20 marks, in relation to sub-criterion 3.17(c).
- 3.7.45 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them
- 3.7.46 By comparison with the other applications, as in relation to sub-criterion 3.17(a), the Authority considered that the BGE(UK) application provided strong evidence of skills and experience relating to high pressure networks (both their operation and construction). This was clearly distinguishable from the PNGL application, but similar to that of NIEH; both applicants' mobilisation proposals were robust and their submissions indicated that the systems and contracts needed were largely in place or could be extended if required. Note was taken of BGE(UK)'s proposal to substitute high pressure pipelines with low pressure pipelines, but this was less credible than PNGL's equivalent proposal, and the rationale for a 12 bar minimum pressure option was confusing and could not be understood. In the round, BGE(UK)'s submission was judged broadly equivalent to that of NIEH in respect of this sub-criterion.

3.8. Specific Criteria – Innovation & Technology

- 3.8.1 BGE(UK) addressed innovation and technology transfer in a standalone document submitted as part of its application (the ITT).
- 3.8.2 The ITT did not systematically address the matters listed in paragraph 3.21 of the Criteria. Instead it sought to demonstrate a history of innovation within the BGE group and BGE(UK), the factors driving the delivery of innovation, and outputs such as cost efficiencies.

Environmental sustainability

- 3.8.3 The ITT made reference to 'environmental tools'¹²⁸ and the award of Business Working Responsibly Mark certification for responsible and sustainable business practices in 2013¹²⁹.
- 3.8.4 Under the heading of 'environmental tools' BGE(UK) stated that it has developed an environmental policy and has also achieved National Standard Authority of Ireland (NSAI) accreditation of Environmental Management System to I.S. EN ISO 14001:2004.
- 3.8.5 The ITT stated that this policy is implemented through techniques developed by BGE(UK) such as Envirokit and Enviroplan, and that it is currently in the process of developing Enviroops. These documents are designed to provide guidance to planning and assessment, operations, construction and office staff and will be applied to activities undertaken in respect of the licence.
- 3.8.6 As noted in Chapter 2 of the provisional decision paper, the Authority understands 'innovation' to mean the design or commissioning, and implementation, of genuinely new technology, methods, processes or procedures. Likewise it understands 'technology transfer' to mean the implementation of the fruits of innovation in a context other than that in which the innovation originally took place.
- 3.8.7 The Authority did not consider that BGE(UK) had provided sufficient indication that the guidance documents it describes could be regarded as being genuinely innovative in respect of environmental sustainability. Likewise, the award of the Business Working Responsibly Mark certification, while no doubt positive, is not in itself evidence of innovation of the sort that the Authority is required to assess under the ITT sub-criteria.

Efficiency in use of gas and new sources of gas

- 3.8.8 In relation to efficiency in the use of gas BGE(UK) point to the fact that the replacement of modulating boilers with modulating condensing boilers results in

¹²⁸ BGE(UK), *Gas to the West: Innovation and Technology Transfer*, p. 21.

¹²⁹ *Ibid*, p. 22.

significant fuel and CO₂ savings as condensing boilers are approximately 90% efficient. Also that BGE are engaged in a pilot project to upgrade some boiler units with small CHP boilers which is expected to significantly reduce electrical demand at their larger installations¹³⁰.

3.8.9 The ITT provided some information regarding measures to improve efficiency in use of gas, but none of the information indicated that the examples given arose from innovation on the part of BGE(UK).¹³¹

3.8.10 In relation to the use of new sources of gas, BGE(UK) stated that it is 'actively engaged in reviewing options for renewable gas' and that as this technology is developed it could be transferred to Northern Ireland.¹³² However, no details are given of existing innovations on the part of BGE(UK).

3.8.11 The Authority considered that it could give no real weight to these examples. A broad statement that BGE(UK) is reviewing options in relation to biogas is not evidence of innovation, nor is a statement that as technology develops it will be transferred to Northern Ireland evidence of technology transfer.

Cost efficiency

3.8.12 The ITT detailed a number of projects relevant to high pressure pipelines and provided identified cost savings in respect of some of them; for example the introduction of an in-house solution for temporary filtration for pipeline pigging which has generated cost savings of circa €1.5m over five years.¹³³ BGE(UK) also point to the fact that the introduction of pre-insulated transmission pipe has resulted operational savings due to reduced repairs to pipeline coating and a reduced frequency of inspections. However, these savings have not been quantified.¹³⁴

3.8.13 The Authority considered that there was some reasonable examples provided by BGE(UK) under this heading but others which could broadly be characterised as good business practice rather than as evidence of innovation on the part of

¹³⁰ Ibid, p. 16.

¹³¹ See explanation of the Boiler replacement Programme and the introduction of combined heat and power units in *ibid*, section 3.5.1, p.16.

¹³² Ibid, section 3.5.2, p.17.

¹³³ Ibid, section 3.1.1, p.8.

¹³⁴ Ibid, p.8

BGE(UK) itself.

- 3.8.14 The development of the network to more remote geographical areas
- 3.8.15 The ITT provided a summary of how the existing gas network in Northern Ireland has developed and stated that 'BGE (UK) has worked successfully to rollout infrastructure with the Utility Regulator and will continue to meet the needs of growth to extend the gas network to the benefit of the Northern Ireland consumer'.¹³⁵
- 3.8.16 No specific proposals for the development of the G2W high pressure network to more remote geographical areas were provided.
- 3.8.17 The Authority considered that the mere statement that BGE(UK) has delivered other networks is insufficient evidence of its ability to achieve innovation and technology transfer under this heading.
- 3.8.18 Such information is relevant to the experience on which BGE(UK) can draw in constructing and operating high pressure networks and has been credited under other headings. However, it did not signal the use of innovation and technology transfer in relation to network development in remote areas.

History of innovation

- 3.8.19 BGE(UK) cites a number of examples of previous innovation, for example¹³⁶:
- 3.8.20 the use of pre-insulated transmission pipes leading to time and operational savings in repairs to pipeline coating, which has reduced the frequency of inspections, thereby delivering a higher quality product; and
- 3.8.21 the introduction of an in house solution to temporary filtration for pipeline pigging. BGE(UK) developed an in-house solution to the need to filter the gas at the point where the pig is extracted in advance of re-injecting it into the pipeline.
- 3.8.22 The Authority attached weight to these examples as demonstrations of an ability to innovate generally in relation to high pressure pipelines. The Authority considered that the first of these innovations was relevant to the network which

¹³⁵ Ibid, section 3.6, p. 18.

¹³⁶ Ibid, sections 3.1.2 and 3.1.3, p. 8

is the subject of the licence application and that the second was illustrative of an ability to innovate more generally. However, the examples were limited and it would have expected a greater effort to be made to draw out how these examples illustrated an ability to innovate in relation to the network licence to which the application relates. In consequence, only limited weight was given to these parts of the submission for the purposes of this sub-criterion.

Ability to secure funding

- 3.8.23 The ITT provided no information relating to BGE(UK)'s ability to secure funding from other governmental or regulatory authorities. Rune concluded in its advice to the Authority that no evidence had been provided by BGE(UK) of its ability to secure funding for innovative developments¹³⁷.
- 3.8.24 The Authority therefore concluded that BGE(UK) had failed to provide any information relevant to this heading.

Transfer of innovation into Northern Ireland

- 3.8.25 The ITT set out no substantive proposals to transfer any innovation into Northern Ireland. This was noted in the report from Rune.¹³⁸
- 3.8.26 The Authority noted that, as indicated above, BGE(UK) stated that as technology in relation to biogas is developed it 'could be transferred to Northern Ireland'.¹³⁹ However, this statement was too tentative to constitute a proposal to transfer innovation and, in any event, the innovation in relation to biogas is not described.
- 3.8.27 The Authority did not consider that the application substantially addressed the issues required to be considered by it under this heading.

Existing skills and experience

- 3.8.28 The existing skills and experience of BGE(UK) staff in relation to innovation were not detailed in the application. Instead, the ITT discussed BGE(UK)'s Network Transformation Programme (NTP) and BGE's competency and performance

¹³⁷ RUNE Associates, *Gas to the West: Technical Advice on High Pressure Submissions*, 19 June 2014, p. 19.

¹³⁸ Ibid.

¹³⁹ BGE(UK), *Gas to the West: Innovation and Technology Transfer*, section 3.5.2, p. 17.

management framework.¹⁴⁰

3.8.29 It was not clear from the application how either the NTP or the performance management framework drives the skills and experience needed for innovation.

3.8.30 As noted in Chapter 2 of the provisional decision paper, sub-paragraph 3.21(b)(iv) of the Criteria refers to 'existing skills and experience'. The Authority therefore considered that it was able to give no credit under this heading in respect of any skills or experience which may be gained by staff in the future as a result of performance management.

3.8.31 However, the Authority recognised that there is some overlap between this sub-paragraph and sub-paragraph 3.21(b)(i), as evidence of a history of innovation is one way in which skills and experience may be demonstrated.

Final Conclusion

3.8.32 The Authority considered that some credit should be given to BGE(UK) for the examples of innovation in high pressure pipelines that it presented in its application. However, generally it considered that limited weight should be attached to those examples, as the ITT made little attempt to illustrate how they demonstrated skills and experience which were of relevance to innovation in the context of the G2W project.

3.8.33 In relation to efficiency in the use of gas, BGE(UK) provided a number of examples where engineering measures have or are expected to result in reduced fuel use; such as the pilot project to upgrade some boiler units with small CHP boilers.

3.8.34 BGE(UK) cites a number of examples of previous innovation. The Authority attached weight to these examples as demonstrations of an ability to innovate generally in relation to high pressure pipelines.

3.8.35 As set out more fully in chapter 2, in arriving at its final score for 3.17(c) the Authority considered the response made by BGE(UK) to the provisional decisions. BGE(UK) stated that it did not believe that its scoring in relation to

¹⁴⁰ Ibid, section 2, pp. 5 - 7.

Information and Technology Transfer, when viewed relative to that of other applicants, fully reflected the strength of its application.

- 3.8.36 The Authority reviewed its scoring against the relevant Criteria for the purpose of reaching its final conclusions. In doing so, it noted BGE(UK)'s comments, but in the absence of any more particularised challenge to the provisional marks did not consider that there was any ground for changing those marks.

Final score for the ITT sub-criteria

- 3.8.37 Having regard to the application and in particular to the matters identified above, the Authority confirms that the BGE(UK) application should attract a low score, and its final decision is to award 9 out of 20 marks, in relation to the ITT sub-criteria, to be allocated equally between sub-criteria 3.21(a) and (b).
- 3.8.38 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.
- 3.8.39 When compared with the other applications, the Authority considered that the BGE(UK) application provided limited evidence of its ability to achieve innovation and technology transfer when set against that of NIEH. As to some of the matters to be considered by the Authority no relevant evidence was given by BGE(UK). Its application was more closely comparable to that of PNGL in respect of ITT, but attracted a slightly higher mark because some of its history of innovation had relevance to high pressure pipelines, and was therefore of greater relevance to the licence being sought.
- 3.8.40 In relation to efficiency in the use of gas, BGE(UK) provided a number of examples where engineering measures have or are expected to result in reduced fuel use; such as the pilot project to upgrade some boiler units with small CHP boilers.
- 3.8.41 Limited information has been provided in regard to the matters listed in 3.21(b), for example, BGE(UK)'s ability to secure funding has not been addressed. Proposals to transfer innovations into Northern Ireland are limited and the existing skills and experience of BGE(UK)'s staff in relation to innovation are not detailed. (BGE(UK) cites a number of examples of previous innovation. The

Authority attached weight to these examples as demonstrations of an ability to innovate generally in relation to high pressure pipelines.

3.9. Resources Criteria

- 3.9.1 Having carried out a detailed analysis of the BGE(UK) application, and in particular considered the OBP for the purpose of awarding marks under sub-criteria 3.17(a) to (c), the Authority then considered whether BGE(UK) meets each of the Resources Criteria.
- 3.9.2 As described in Chapter 2 of the provisional decisions, and for the reasons set out there, this entailed taking the Resources Criteria out of the formal sequence in which they appear in the Criteria, and considering them as a final check on the application as a whole; following, and drawing on the detail, of the analysis of the OBP.
- 3.9.3 On this basis, for the purposes of these two criteria, the Authority carried out an overall assessment of the information and evidence that was revealed by the BGE(UK) application in relation to the adequacy of its resources.
- 3.9.4 More specifically, the Authority:
- a. considered carefully whether BGE(UK) has demonstrated that it has, or is making appropriate arrangements to obtain, the resources required to meet the obligations to be included in the conditions of the high pressure licence (the Adequate Resources Criterion); and
 - b. considered in particular whether BGE(UK) has demonstrated that it has the resources and financial standing to undertake the activities to be carried out for the purposes of meeting those obligations (the Financial Resources and Standing Criterion).
- 3.9.5 For these purposes, the Authority had particular regard to whether BGE(UK) has demonstrated that it will have the financial resources for the construction of the high pressure network while being subject to a revenue restriction that reflects the financial terms of its application. This will constitute the most substantial obligation of any applicant which is successful in obtaining the licence.

Assessment following sub-criteria 3.17(a) to (c)

- 3.9.6 In carrying out this assessment, the Authority began with the marks awarded by it in relation to sub-criteria 3.17(a) to (c).
- 3.9.7 As indicated above, BGE(UK) was awarded a 'high' score in respect of sub-criterion 3.17(a), a 'medium' score (at the top end of that range) in respect of sub-criterion 3.17(c), and a 'low' score (at the top end of that range) in respect of sub-criterion 3.17(b).

Sub-criteria 3.17(a) and (c)

- 3.9.8 As explained in Chapter 2 of the provisional decisions, where an applicant is awarded marks which fall within the medium to high parts of the range, it might be expected that its application would reveal a broad adequacy of resources for the purposes of the licence.
- 3.9.9 Sub-criteria 3.17(a) and (c) are essentially concerned with the assessment of the application in relation to what the Adequate Resources Criterion describes as 'systems and apparatus' and 'human and other resources'.
- 3.9.10 In respect of these sub-criteria, BGE(UK) is awarded, once the marks were given their appropriate weighting for the purpose of the Best Value Criterion, 81% of the available marks.
- 3.9.11 This is consistent with what was anticipated in Chapter 2 of the provisional decisions, and what was in fact found by the Authority on its assessment of the relevant parts of the OBP, which is that these scores reflect provisional conclusions by the Authority which reveal a broad adequacy of the relevant resources on the part of BGE(UK).
- 3.9.12 The Authority's assessment of the quality of information and evidence submitted in the relevant parts of the OBP is set out above, and need not be repeated here in full.
- 3.9.13 In summary, what the Authority identified was that BGE(UK), with its experience of constructing and operating high pressure networks in Northern Ireland, had

produced clear and detailed evidence that it either has, or is making appropriate arrangements to acquire, the systems, apparatus, human and other resources required for the purposes of the G2W high pressure licence.

Sub-criterion 3.17(b)

- 3.9.14 As explained in Chapter 2 of the provisional decisions, where an applicant is awarded marks which fall within the low part of the range, that is likely to call into question whether its application reveals an adequacy of resources and therefore requires careful further analysis.
- 3.9.15 In respect of the financial information and evidence considered under sub-criterion 3.17(b), BGE(UK) obtained 45% of the available marks. This was at the top end of the 'low' range, but it nonetheless requires questions to be asked about whether BGE(UK) has access to the financial resources it requires for the purposes of both the Adequate Resources Criterion and the Financial Resources and Standing Criterion.
- 3.9.16 In considering this matter, the Authority noted that the BGE(UK) score in relation to sub-criterion 3.17(b) mainly reflected the incompleteness and lack of detail in elements of its description of the how the data in the Data Input Workbook were derived. Elements of the description were sound and well-evidenced, but others were not complete or only inadequately evidenced. In relation to some data, no supporting information was provided, and there were indications of potential errors.
- 3.9.17 This inconsistency in the quality of the submission is reflected in a final mark which rates this part of the application as close to, but still falling short of, the medium range.
- 3.9.18 For the purposes of the Resources Criteria, the Authority considered that there were two mitigating aspects to the overall low score.
- 3.9.19 First, the more complete element of this part of the BGE(UK) application related to its description of how the WACC was derived. The Authority considered this to be broadly reasonable, although lacking in some detail and capable of having been improved. The weaker aspect of the application related to the description of the capital expenditure data.

- 3.9.20 For the purposes of assessing whether BGE(UK) has, or will be able to obtain, the required financial resources, it is the WACC figure which is most important.
- 3.9.21 Second, the Authority considered, for the purpose of testing the assumptions made by BGE(UK), whether its proposed WACC of 6.09% was such that it would be able to raise the finance required to construct and operate the high pressure network while subject to a revenue control condition embodying that WACC. The Authority concluded that this was a robust assumption, and indeed that it had no concerns about the ability of BGE(UK) to finance its activities under the high pressure licence on the basis of the proposed WACC.
- 3.9.22 The reasons for this are described above. In short, they are as follows:
- a. The WACC falls within NERA's plausible range.
 - b. The WACC lies at the very top of that range. As it is included in the Data Input Workbook it influences the calculation of the marks awarded to BGE(UK) for the Applicant Determined Costs sub-criterion, and because it is comparatively high it will for that reason be adverse to BGE(UK) in that context. However, for the purposes of the Resources Criteria a high WACC raises fewer concerns than a low one, since it is reflective of a cost of debt and equity that would be likely to attract investors.
 - c. In any event, BGE(UK) intends to finance the project through corporate finance, has evidenced by reference to its financial statements and access to finance facilities that it has the resources, and has already received the approval of its Board of Directors to fund the project.
- 3.9.23 In addition BGE(UK) has provided historical evidence of having raised finance for the construction of high pressure pipelines in Northern Ireland.
- 3.9.24 Taking all of these points together, the Authority's final conclusion is that the factors which led BGE to receive a low score in relation to sub-criterion 3.17(b) are not ones which in fact serve to call into question whether it has the requisite financial resources to undertake the licensed activities.

Final Conclusion

- 3.9.25 On the basis of the information and evidence provided to it in the BGE(UK)

application, the Authority had no reason to question that BGE(UK) will have the non-financial resources that it requires for the purposes of the high pressure licence. Those matters are well-evidenced.

3.9.26 The Authority did consider whether the weaker elements of BGE(UK)'s OBP in relation to the data in its Data Input Workbook called into question whether it has or can obtain the financial resources required for the purposes of the licence, but concludes that, for the reasons given above, they do not.

3.9.27 Therefore, the Authority concludes that BGE(UK):

- a. has demonstrated to its satisfaction that it either currently has, or is making appropriate arrangements to ensure that it would have in place by the time it would commence regulated activities under the high pressure licence (if granted), the financial and other resources likely to be sufficient for the purposes of meeting its obligations under the conditions of that licence; and,
- b. has demonstrated that it has the resources and financial standing to undertake the activities to be carried out for the purposes of meeting those licence obligations.

3.9.28 In consequence the Authority's final conclusion is that BGE(UK) meets both of the Resources Criteria.

4.0 BGE(UK) High Pressure Unconnected

4.1. Introduction

4.1.1 This chapter:

- a. considers the application made by BGE (UK) Limited (**BGE(UK)**) for the high pressure licence, which is unconnected to any other application;
- b. the responses received to the consultation on the provisional decisions, as these relate to the unconnected application made by BGE(UK)
- c. sets out the Authority's final conclusions as to whether BGE(UK) has met each of the criteria other than the Best Value Criterion;
- d. sets out the Authority's final assessment of the marks to be awarded to BGE(UK) in respect of the different elements of the Best Value Criterion;
- e. explains the reasons of the Authority for its final conclusions and marks.

4.1.2 In this chapter, the criteria have been addressed in the order in which they are set out in Chapter 2 of the provisional decisions, and the Authority has followed the approach to interpreting and applying the criteria that is set out in that chapter.

4.2. The Information Criterion

4.2.1 Both an electronic and a printed copy of the BGE(UK) application were received by the Authority before the deadline of noon on 6 May 2014.

4.2.2 Once the deadline had passed the application was opened and checked for completeness against a pre-prepared checklist. The application was assessed as being complete except in two respects:

- a. it was not clear from the application what information was being relied on by BGE(UK) for the purposes of meeting the Adequate Resources

Criterion; and

- b. it was not clear from the application what information was being relied on by BGE(UK) for the purposes of meeting the Financial Resources and Standing Criterion.
- 4.2.3 BGE(UK) was informed of these apparent omissions and was given until noon on 14 May 2014 to provide the missing information. A response was received by the deadline and it was subsequently judged that this addressed the omission in full¹⁴¹.
- 4.2.4 Having considered these facts, the Authority concluded that BGE(UK) has provided all the information requested by the Authority, in such manner and by such times as was specified, and therefore meets the Information Criterion.

4.3. The Constitution Criterion

- 4.3.1 BGE(UK) is a limited company with its registered office in England. BGE(UK)'s constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations¹⁴².
- 4.3.2 Having considered this evidence, the Authority was satisfied that BGE(UK) has demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.

4.4. The Fit and Proper Person Criterion

- 4.4.1 Evidence to demonstrate that BGE(UK) is a fit and proper person was provided to the Authority in accordance with paragraphs 20 to 26 of Schedule 2 to the Application Regulations¹⁴³. It consisted of a signed statement by a senior officer of BGE(UK) to the effect that BGE(UK) had no information to disclose under any of those paragraphs.

¹⁴¹ BGE (UK) Statement of Supporting Information for Submission to NIAUR 14-05-14

¹⁴² HP Unconnected Schedule 3 part 1

¹⁴³ Gas_to_the-West_Annex_3 Unconnected Application

- 4.4.2 The Authority noted that BGE(UK) has no record of enforcement action being taken against it, or any other adverse factor of the type listed in the Application Regulations.
- 4.4.3 On the basis of the evidence provided to it, the Authority was therefore satisfied that BGE(UK) meets the Fit and Proper Person Criterion.

4.5. Specific Criteria – Operational Business Plan 3.17(a)

Engagement with stakeholders

- 4.5.1 BGE(UK) stated that it has held a number of pre-meetings with stakeholders such as the Planning Service, Roads Services, and NI Environment Agency. It also listed a number of other stakeholders with whom it has developed relationships through previous projects. These included Premier Transmission Limited (PTL), Phoenix Natural Gas, firmus energy, the Northern Ireland Road Authority, the Utilities Committee of the Department of Regional Development, and the Centre for Protection of National Infrastructure¹⁴⁴.
- 4.5.2 Landowners were identified as a key stakeholder in the pipeline construction process and BGE(UK) demonstrated in its application that it understands the importance of engagement with this key stakeholder group, has experience of such engagement, and has an appropriate plan governing its interactions with them as part of the G2W project.
- 4.5.3 BGE(UK) affirmed the importance of wayleaves and stated that it would initiate discussions with the Ulster Farmers Union and farming representatives, with whom it has existing good relationships in place having successfully completed circa 300 km of Transmission pipeline in Northern Ireland¹⁴⁵. BGE(UK) also set out the approach it takes with landowners should any remedial works be necessary¹⁴⁶.
- 4.5.4 In the appendix to its OBP BGE(UK) provided 'The Landowners Handbook' which is a guide for landowners on wayleaves, landowner and occupier

¹⁴⁴ BGE(UK), *Operational Business Plan (Unconnected)*, section 3.6.1.

¹⁴⁵ Ibid, section 3.3.2.

¹⁴⁶ Ibid, section 3.6.1.

agreements, the construction process and post-construction operations and maintenance.

- 4.5.5 In terms of its proposed engagement with other stakeholders which it identified BGE(UK), pointed to its partnership with firmus. It stated that this partnership provides synergies which BGE (UK) and firmus have demonstrated over the past ten years in the construction of the Northwest pipeline, South North pipeline, steel spur lines and the connection of towns along those pipelines. Examples of such synergies included the provision of a single point of contact with statutory bodies and the public, and carrying out co-ordinated public consultations.
- 4.5.6 BGE(UK) stated that both companies will engage frequently with the Department of Regional Development, MLAs and local councillors to keep elected representatives aware of the on-going works and any proposed disruption that may be incurred in their boroughs. It also stated that both companies would work closely with the Carbon Trust and Energy Saving Trust to promote energy efficiency and to endorse the positive contribution natural gas makes to the local carbon footprint¹⁴⁷.
- 4.5.7 The OBP contained a stakeholder engagement plan that was broken down into six stages, from an initial stakeholder liaison and scoping exercise to a final learning and evaluation phase¹⁴⁸. The Authority considered this a comprehensive approach and noted that it was based on previous experience both in Northern Ireland and the Republic of Ireland. It set out the relationships that BGE(UK) has already established through its existing business in Northern Ireland.
- 4.5.8 BGE(UK) stated that at the date of its application it had already held meetings with the Planning Service, Roads Services, and NI Environment Agency, and it provided proposals for public information meetings at Strabane, Enniskillen, Omagh and Dungannon.
- 4.5.9 The Authority considered that BGE(UK) demonstrated that it has identified an appropriate range of key stakeholders, and paid appropriate attention to the key stakeholder group of landowners.

¹⁴⁷ Ibid.

¹⁴⁸ Ibid.

- 4.5.10 The Authority also considered that, through its stakeholder engagement plan and examples of how this has been given effect in previous projects in Northern Ireland, BGE(UK) demonstrated that it has in place comprehensive, detailed and appropriate proposals for stakeholder engagement which were grounded in actual experience serving to establish their deliverability in practice.
- 4.5.11 Skills and experience of key members of staff and any other persons
- 4.5.12 BGE(UK) stated that it intends to rely mainly on the skills and experience of staff already employed within the BGE group and only employ an outsourcing model for certain activities¹⁴⁹.
- 4.5.13 BGE(UK)'s experience of building and operating high pressure pipelines in Northern Ireland and the Republic of Ireland¹⁵⁰ is relevant as evidence of the skills and experience of staff within the company. It has constructed 300km of high pressure pipelines in Northern Ireland and is currently in the construction management phase of a number of 70 barg pipelines in the Republic of Ireland. The majority of these projects are scheduled for completion in 2014 thus freeing up relevant staff resources¹⁵¹.
- 4.5.14 BGE(UK) has an Asset Operations division responsible for the scheduling and completion of capital construction works¹⁵², it named specific key personnel, many of whom have previously worked on relevant projects in Northern Ireland, providing curricula vitae setting out their skills and experience¹⁵³.
- 4.5.15 BGE(UK) stated that the resources currently deployed on high pressure pipeline projects in the Republic of Ireland can be re-deployed to the new licensed area and that BGE(UK) has already established a project management team as part of its preparations for making the licence application. In relation to the project management of construction from the initial mobilisation phase through to the operation and commissioning of the pipeline, BGE(UK) stated that it can offer an end-to-end process based on its project and construction management

¹⁴⁹ Ibid. p. 25 and table 6 at pp. 56 – 57.

¹⁵⁰ Ibid, table 2 at pp. 33 – 35.

¹⁵¹ Ibid. p. 20.

¹⁵² Ibid, section 2.1.

¹⁵³ Ibid, appendix A.

experience of pipelines¹⁵⁴.

4.5.16 The Authority considered that BGE(UK) had provided detailed evidence that many of the staff with the skills and experience required to carry on the licensed activities are already in place within the organisation, and that it has extensive relevant experience of undertaking similar activities. The Authority noted, and placed particular weight on the fact, that BGE(UK) has recent experience of constructing high pressure pipelines in Northern Ireland.

4.5.17 While it was not clear whether the named individuals whose curricula vitae were provided will necessarily constitute the senior management team which the OBP described, the Authority considered that it was clear from the evidence provided by BGE(UK) of the skills and experience within its organisation and wider group that suitable staff to fill such roles will be available to it from existing resources.

4.5.18 In relation to external skills and experience, the application set out the range of framework contracts which BGE(UK) already has in place and can use to access external resources where these are needed to supplement what is available within the company or wider group¹⁵⁵. These cover a range of specialist activities related to engineering services, land agency, and pipeline inspection that will be required for the new licensed area¹⁵⁶. The Authority considered that these were appropriate arrangements to ensure that such external resources as are needed can readily be procured.

Management of risk

4.5.19 BGE(UK) set out its risk management policy in section 4.1 of its OBP. This outlined how risks are identified and managed within the organisation. Section 3.7.4 of the OBP described how BGE(UK)'s approach to the management of risk will be applied to the G2W project.

4.5.20 Drawing on BGE(UK)'s previous experience from similar projects, the OBP also set out key hazards which had been identified in each phase of the construction, commissioning and operation of the pipeline and steps that can be taken to

¹⁵⁴ Ibid. p. 32.

¹⁵⁵ Ibid, table 6 at pp. 56 – 57 and table 14 at p. 130.

¹⁵⁶ Ibid, p. 129.

design out or minimise these hazards¹⁵⁷. It provided a table summarising the likely hazards and failure mechanisms for handling gas in a high pressure transmission system, gave an indication of the likely consequence if there was a failure and included a list of the safeguards to prevent the occurrence of such events¹⁵⁸.

4.5.21 Sections 3.1.2.2 and 3.1.2.3 of the OBP also identified a number of high level programme (and interdependency) risks, for which some generic responses were suggested.

4.5.22 As noted above, BGE(UK) indicated that it held meetings with the Planning Service, Road Service and the NI Environment Agency. From these contacts, together with a review of the potential route for the pipeline and FMA design, it had identified some high level programme risks specifically related to the G2W project.

4.5.23 The Authority considered that BGE(UK) had identified a number of relevant risks associated with the activities which it would be required to undertake under the licence. It has also provided evidence that it has robust systems in place to deal with such risks, and to identify others, and has presented suggestions for the avoidance and mitigation of the risks that it has identified thus far.

4.5.24 This view was supported by the advice received from Rune¹⁵⁹.

Tendering arrangements

4.5.25 In its OBP, BGE(UK) set out detailed information in relation to its tendering arrangements, which the Authority considered demonstrated an understanding of best practice in this regard.

4.5.26 BGE(UK) stated that its project team will include a Contract Manager with responsibility for contract strategy, negotiation and management and that its existing support services will provide procurement support for the contract

¹⁵⁷ Ibid, sections 4.1.2 to 4.1.2.4.

¹⁵⁸ Ibid, sections 4.1.3 to 4.1.5.

¹⁵⁹ RUNE Associates, *Gas to the West: Technical Advice on High Pressure Submissions*, 19 June 2014, p. 2.

arrangements¹⁶⁰.

4.5.27 Policies and procedures to ensure compliance with EU procurement regulations were described and financial thresholds for advertisement in the EU Journal were specified. Competitive tendering and evaluation scoring processes were also described in general terms¹⁶¹.

4.5.28 BGE(UK) stated that it will utilise its current process for contract lifecycle and contract risk management and provided summary details of that process. It also provided information regarding the arrangements it has in place to establish framework contracts where it is likely to have repeated tendering needs, and outlined details of existing contracts of this type that can be utilised for various specialist services¹⁶². Summary details of 17 strategic framework contracts that are relevant to the G2W project were included¹⁶³.

4.5.29 BGE(UK) outlined its strategy for procuring materials and indicated that this strategy would be used for the G2W project. It also stated its intention to utilise its existing framework agreements to procure materials associated with the construction of the pipeline where applicable¹⁶⁴.

4.5.30 These agreements cover a range of materials, including pipe, and BGE(UK) stated that they provide benefits in terms of delivery lead time and bulk purchasing power. Provisional arrangements for on-site storage of pipe had already been investigated by BGE(UK) and were also described¹⁶⁵.

4.5.31 The OBP provided details of the options available for the award of construction contracts based on whether or not the contracting entity is a Northern Ireland company (and thus whether or not EU procurement law requirements apply)¹⁶⁶. It also stated that maintenance contracts which BGE(UK) already has in place in Northern Ireland require only minor amendments to cover the G2W project¹⁶⁷.

4.5.32 Finally, BGE(UK) stated that it will use framework contracts already in place in

¹⁶⁰ Ibid, section 3.1, Fig 4.

¹⁶¹ Ibid, section 6.1.

¹⁶² Ibid, section 6.1.1.1.

¹⁶³ Ibid, section 6.1.1.

¹⁶⁴ Ibid, section 6.2.

¹⁶⁵ Ibid.

¹⁶⁶ Ibid, section 6.3.1.

¹⁶⁷ Ibid, section 6.3.2.

relation to a variety of specialist services¹⁶⁸.

4.5.33 Overall, the Authority considered that BGE(UK) provided clear and detailed information regarding its proposals as to the use of tendering arrangements and that those arrangements were robust and in line with best practice. The Authority noted in particular that BGE(UK) will be able to utilise a number of framework contracts which it already has in place in relation to materials and specialist services.

4.5.34 The Authority attached weight to the fact that these arrangements had been proven effective through their use in previous projects, and to the thought that had been given already by BGE(UK) to their suitability for the G2W project.

4.5.35 This view was supported by the advice received from Rune¹⁶⁹.

Final mark for sub-criterion 3.17(a)

4.5.36 In arriving at its final score for sub-criterion 3.17(a) the Authority considered the response made by BGE(UK) to the provisional decisions. BGE(UK) stated that it did not believe that its scoring in relation to the Operational Business Plan, when viewed relative to that of other applicants, fully reflected the strength of its application, in particular its experience in the management of high pressure pipelines.

4.5.37 The Authority reviewed its scoring against the relevant Criteria for the purpose of reaching its final conclusions. In doing so, it noted BGE(UK)'s comments, but in the absence of any more particularised challenge to the provisional marks did not consider that there was any ground for changing those marks. See chapter 2 for further details.

4.5.38 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the BGE(UK) application should attract a high score, and its final decision is to award 18 out of 20 marks, in relation to sub-criterion 3.17(a).

¹⁶⁸ Ibid, section 6.3.3.

¹⁶⁹ RUNE Associates, *Gas to the West: Technical Advice on High Pressure Submissions*, 19 June 2014, pp. 4 – 5.

- 4.5.39 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.
- 4.5.40 When compared with the other applications, the Authority considered that the BGE(UK) application provided a comprehensive and well-evidenced statement of how it would carry out activities under the licence. It presented evidence of strong skills and experience in relation to high pressure networks (both their operation and construction), adequately reflected in its plans in relation to the G2W project. It could be distinguished from the much weaker PNGL application on this basis. NIEH submitted an application that also evidenced good skills and experience and was much closer to that of BGE(UK), but BGE(UK) was slightly stronger in its ability to draw on recent experience of building high pressure pipelines in Northern Ireland and reflect that experience in forward plans, such as its good and detailed proposals for engagement with landowners.

4.6. Specific Criteria – Operational Business Plan 3.17(b)

- 4.6.1 Table 4.1 below sets out the values for each of the cost items submitted by BGE(UK) in its application¹⁷⁰.
- 4.6.2 These figures cover all the relevant data that were provided by BGE(UK) and therefore carried out its assessment for the purposes of sub-criterion 3.17(b) against BGE(UK)'s description of its derivation of those data.
- 4.6.3 The Authority divided the costs into two broad categories of WACC and Capital Expenditure. The Capital Expenditure category consisted of four separate cost lines: Design/Project Management, Contingency, Mobilisation and Other Applicant Costs. These cost lines are consistent with what the Authority stated applicants should supply in the Data Input Workbook¹⁷¹.

¹⁷⁰ BGE (UK) Unconnected High Pressure Data Input Workbook.

¹⁷¹ To assist the applicants the Authority also provided some detail on each cost area in the Application Information Pack

Table: 4.1 BGE (UK) Unconnected High Pressure Data Input Workbook Cost Items

Cost Item	Value
Weighted Average Cost of Capital	6.19%
Design / Project Management	£12.242m
Contingency	£4.328m
Mobilisation	£0.300m
Other Applicant Costs	£0.000m

Description of the derivation of cost data

Weighted Average Cost of Capital

4.6.4 NERA was requested to produce a report on what it would expect to see in a well-evidenced WACC submission. The Authority substantially agreed with the assessment reflected in that report. It follows the Authority would have expected to see:

- a. The cost of debt set out using: (i) a benchmark gilt yield (to reflect a risk free rate) plus evidence on corporate debt spreads with market evidence provided for both; and/or (ii) direct evidence of corporate debt yields with market evidence provided. For this purpose, references to corporate debt spreads/yields should reflect companies with similar risk profiles, issuance costs should be included in the cost of debt and the treatment of inflation should be clearly explained in the derivation.
- b. The cost of equity set out using CAPM and incorporating the risk free rate, equity risk premium and beta with relevant evidence provided to justify each component.
- c. The proposed gearing including a discussion on the how this interacts with the risks of the project, the proposed credit rating and the cost of debt.

- 4.6.5 BGE(UK)'s application was based on a standard debt/equity capital structure and included proposals for both debt and equity costs.
- 4.6.6 The Authority considered that the application gave a reasonable but incomplete description of how the cost of capital figure in the Data Input Workbook was built up¹⁷².
- 4.6.7 Table 18 provided a clear presentation of the components used to calculate the proposed WACC. For cost of debt a figure of 3% was proposed. It was stated that this was taken from a range of possible values derived by establishing the upper and lower bounds of possible values. The lower bound was derived from the iBoxx index and the upper bound figure was taken from the Utility Regulator determination on the BGE (UK) price control in October 2012¹⁷³. The application also clearly set out how it had accounted for inflation and transaction costs¹⁷⁴.
- 4.6.8 The Authority considered the explanation of the upper and lower bounds to be in line with reasonable expectations, and well-evidenced with a reasonable amount of clarity provided. The Authority also regarded the use of regulatory precedents in explaining the inflation and transaction cost figures to be of assistance in understanding the derivation of the data.
- 4.6.9 However, the actual lower bound figure was not stated and there was very limited explanation of how the final figure for the cost of debt was arrived at. This demonstrated some lack of clarity in the application.
- 4.6.10 To estimate the cost of equity, CAPM had been applied and a figure of 12.44% was proposed. There was a useful discussion of the estimates of the Total Market Return to Equity¹⁷⁵, the Risk Free Rate and the Equity Risk Premium values with clear reference made to recent regulatory determinations, together with an explanation of why BGE(UK) preferred to rely on Ofgem's RIIO-T1 and RIIO-GD1 than the Competition Commission's NIE determination in arriving at a final figure.
- 4.6.11 In estimating the beta values, the application referenced Table 19, describing

¹⁷² BGE (UK) Unconnected Gas to the West Operational Business Plan – Chapter 10.

¹⁷³ BGE((NI) Ltd. Price Control 2012-2017 Determination, para. 6.23, p.28.

¹⁷⁴ BGE (UK) Unconnected Gas to the West Operational Business Plan p.169.

¹⁷⁵ The Total Market Return to Equity is the sum of the risk free rate plus the equity risk premium.

different types of comparator companies and sectors which BGE(UK) stated that it had considered in arriving at those values.

4.6.12 The Authority considered the explanation of the Total Market Return to Equity, Risk Free rate and Equity Risk Premium to be well-explained and the reliance on recent regulatory precedents to be well-evidenced. However, the derivation of the final figure could have benefited from more detailed explanation.

4.6.13 Beta figures were not provided in Table 19 and it was unclear to the Authority what the proposed range was or how the final figure for asset beta values was arrived at. The application in this respect is simply not complete.

4.6.14 The Authority also noted that the 2% upper estimate for the risk free rate used in the cost of debt section¹⁷⁶ appeared to be inconsistent with the 1.5% figure used in the equity section¹⁷⁷ and regarded this inconsistency as weakening the quality of the evidence provided in the application.

4.6.15 NERA also found that, taken in the round, BGE(UK)'s description of how it had derived its cost of debt was well-evidenced, but that there was no explanation of the determination of the final figures proposed¹⁷⁸.

4.6.16 While NERA advised that the cost of equity component was well-evidenced¹⁷⁹, the Authority considered that the evidence provided was incomplete (e.g. asset beta data) and inconsistent in places (e.g. risk free rate) and to that extent was not as clear or full a description as it would have expected.

Capital Expenditure

4.6.17 BGE(UK) provided an explanation of some of its cost items but not others. No spreadsheet was provided to allow a detailed analysis of all the figures.

4.6.18 The Design and Project management and Mobilisation values in the Data Input Workbook were calculated using a function of Maximo, the asset management system, known as Compatible Units¹⁸⁰. This records costs from previous projects

¹⁷⁶ BGE (UK) Unconnected Gas to the West Operational Business Plan, p. 169.

¹⁷⁷ BGE (UK) Unconnected Gas to the West Operational Business Plan, p. 170.

¹⁷⁸ NERA, Gas to the West, A Report for the Utility Regulator, Section 2.2.2 p. 6.

¹⁷⁹ NERA, Gas to the West, A Report for the Utility Regulator, Section 3.2.1 p. 12.

¹⁸⁰ BGE (UK) Connected Gas to the West Operational Business Plan – Section 3.4 and 9.2.

and converts them into comparable units. Values were therefore based on experience of previous projects and the G2W high pressure network design produced by Fingleton McAdam. There was also some additional breakdown of the costs provided in Table 16, e.g. Design and Planning, but no spreadsheet was provided with any detailed explanation. The Authority also notes that the value in this cost line is £0.300m above that set out in the BGE(UK) Connected application.

- 4.6.19 There was no explanation given for the contingency figure.
- 4.6.20 While the Authority considered the use of Maximo to be a robust approach, there were only high level final figures presented in the application and no detail as to how the values in the Data Input Workbook were derived. Given the use of a building block system to calculate the figures, the Authority would have expected a detailed discussion of the various elements used to derive the final figure.
- 4.6.21 This deficiency was demonstrated by the fact that there were different figures inserted in Table 16 for Project Management in this (the BGE(UK) unconnected¹⁸¹) application and in the BGE(UK) connected¹⁸² application. There was no self-evident reason for the difference, and in the Authority's opinion, in an adequately explained submission it would have been possible to ascertain if there was a reason behind this difference or if it was just an error.
- 4.6.22 The Authority also noted that, since the activities included in Mobilisation are specific to the G2W project and relate to establishing commercial arrangements to convey gas across the pipeline, a more tailored approach to calculating this figure would have been appropriate.
- 4.6.23 The Authority also noted and had regard to the fact that the Mobilisation value of £0.300m appeared to have been double counted. BGE(UK)'s Table 16 described the Design/Project Management figure of £12.2m which was included in the Data Input Workbook¹⁸³. The table clearly included £0.300m mobilisation costs in this overall figure. However, the Data Input Workbook also included a separate

¹⁸¹ BGE(UK) Connected Gas to the West Operational Business Plan, p.162

¹⁸² BGE(UK) Connected Gas to the West Operational Business Plan, p.171.

¹⁸³ Data Input Workbook Design & Project Management £12.242m Mobilisation £0.300m - BGE(UK) Unconnected Gas to the West Operational Business Plan – Table 16 Project Management + Design % Planning £11.942 Mobilisation £0.300m.

and additional amount for mobilisation of £0.300m.

- 4.6.24 As there was no explanation provided for the contingency figure, the Authority considered this part of the information provided to be incomplete.

Identification and application of cost drivers

- 4.6.25 BGE(UK) used a compatible unit estimate approach to build up the activities for the G2W project based on its pipeline construction experience. While BGE(UK) provided Table 16, there was a very limited breakdown of the costs provided in this table.¹⁸⁴
- 4.6.26 The Authority considered that it was not possible to ascertain from this what cost drivers had been used to build up costs, and the evidence provided in relation to cost drivers had therefore to be assessed as weak.

Robustness of assumptions

- 4.6.27 The Authority identified and considered a number of assumptions that appeared to have been made by BGE(UK) when deriving the data contained in its Data Input Workbook.

The Value of the WACC

- 4.6.28 First, the Authority took it to be implicit throughout the application that BGE(UK) had assumed it will be able to carry on the licensed activities under the high pressure licence, and to do so consistently with its obligations under that licence, on the basis of the proposed WACC. That is to say, there was an implicit assumption that BGE(UK) will be able to raise the finance required to construct and operate the high pressure network while subject to a revenue control condition embodying its proposed WACC.
- 4.6.29 For the purpose of testing this assumption, the Authority considered whether the proposed WACC fell within the range of what might reasonably be expected in the context of the G2W project. To do this, it considered the market cost of debt and equity based on advice received from NERA, which took into account in its report such costs as referenced in recent regulatory decisions¹⁸⁵. NERA advised

¹⁸⁴ BGE(UK) Unconnected Gas to the West Operational Business Plan, p.162.

¹⁸⁵ NERA, Gas to the West, A report for the Utility Regulator

on what it considered to be the 'plausible range' within which it would expect any WACC for this project to lie. The Authority relied upon the advice contained in the report as establishing a range against which to test BGE(UK)'s assumption

- 4.6.30 NERA established a 'plausible range' in respect of a debt/equity model of 3.5% - 6.2%¹⁸⁶, and BGE(UK)'s proposed WACC was 6.09%.
- 4.6.31 The Authority noted that the proposed BGE(UK) WACC lay at the high end of, but fell within, the range identified by NERA.
- 4.6.32 In addition BGE(UK) identified its ability and intention to finance the project through corporate finance, and referenced its 2012 financial statements and its access to finance facilities¹⁸⁷. It stated that it had already received the approval of its Board of Directors, so that financial resources were available to complete the project¹⁸⁸. In addition it provided historical evidence that it had raised finance for construction of high pressure pipelines in Northern Ireland¹⁸⁹.
- 4.6.33 Having regard to its own expertise, the Authority considered that the proposed WACC was high and therefore reflective of a cost of debt and equity that would attract investors. Given that the WACC also lay within NERA's plausible range, and that the proposal was in any event to fund the project on a corporate finance basis, with evidence of a board level approval already in place, the Authority had no concerns about the ability of BGE(UK) to finance its activities under the high pressure licence on the basis of the proposed WACC.
- 4.6.34 Therefore the Authority concluded that the assumption that BGE(UK) would be able to obtain financing to carry on the licensed activities on the basis of the proposed WACC was robust.

Transaction Costs

- 4.6.35 Second, the BGE(UK) proposed WACC included an adjustment of 0.2-0.3% for transaction costs associated with raising finance. This was based on regulatory precedent, including the recent Competition Commission determination relating to Northern Ireland Electricity.

¹⁸⁶ NERA p. 33

¹⁸⁷ BGE (UK) Annex 3 Form of Application p9

¹⁸⁸ BGE (UK) Responses to Email from Utility Regulator, 9th May 2014

¹⁸⁹ BGE (UK) Annex 3 Form of Application p9

- 4.6.36 The Authority considered this assumption to be robust in light of the explanation given in support of it, and could identify no reason why the references cited by BGE(UK) would not be of relevance to the G2W project.

Gearing

- 4.6.37 Third, BGE(UK) proposed¹⁹⁰ a gearing ratio of 75% based on a survey of gearing ratios of utilities in the United Kingdom. There was no discussion as to whether or not this level of gearing would be appropriate, given the level of project risk assumed elsewhere in the application.
- 4.6.38 NERA advised that the assumptions relating to gearing could not be considered as robust due to a lack of evidence in support of them¹⁹¹. The Authority also concluded that the application provided incomplete evidence in this regard and agreed with the NERA advice.

Asset Beta

- 4.6.39 Fourth, the asset beta section of the application¹⁹² includes assumptions relating to ground conditions and construction risk and how they should impact on betas. However, no detailed evidence was provided as to why the level of risk might compare with United States Construction or Renewable Generation.
- 4.6.40 The Authority would have expected to be provided with examples of similar gas transmission assets regulated in such a manner elsewhere, particularly as BGE(UK) notes previous experience with poor ground¹⁹³.
- 4.6.41 In addition the Authority noted that no reference was made to calculations which other regulators have used in determining how companies with different levels of construction risk might require different beta figures e.g. Ofgem RIIO - GD1.
- 4.6.42 The Authority had questioned similar arguments previously¹⁹⁴ and BGE(UK) provided no additional evidence in support of them. In principal, the Authority was not convinced that project specific risk, e.g. as to ground conditions, should

¹⁹⁰ BGE (UK) Unconnected Gas to the West Operational Business Plan, p. 171.

¹⁹¹ NERA 4.2.1 p. 16.

¹⁹² BGE (UK) Unconnected Gas to the West Operational Business Plan, p. 169.

¹⁹³ BGE (UK) Unconnected Gas to the West Operational Business Plan – p. 64.

¹⁹⁴ Utility Regulator, Gas Network Extensions in NI: Approach to comparing HP licence Applications, 6 Feb, p. 7.

impact on beta values which are intended to measure the impact of market wide systematic risk on the investment in question when measured against the impact on the market as a whole. BGE(UK)'s application failed to address this issue.

- 4.6.43 The Authority was therefore unable to regard BGE(UK)'s assumptions in relation to the impact of such risk on betas as being robust.

Duration of the WACC

- 4.6.44 Fifth, the Authority noted the statement made by BGE(UK) that the WACC must be allowed throughout the project lifetime¹⁹⁵. This statement is inconsistent with the Authority's clearly expressed position as outlined in the Applicant Information Pack¹⁹⁶. To the extent that BGE(UK)'s application is premised on an assumed unchangeable WACC, that assumption is not robust.

Capital Expenditure

- 4.6.45 Sixth, BGE(UK)'s calculation of capital expenditure costs used Maximo and they were built up from other gas high pressure construction projects. This assumed that the pipeline will have a similar cost structure to other high pressure pipelines on the island of Ireland.
- 4.6.46 The Authority recognised this as a robust assumption in most cases. However, as noted above, the Authority considered that mobilisation costs may not suit such a generic approach given the very specific costs included within this overall cost line. To that extent a caveat must be attached to the assumption.

Final Conclusion

- 4.6.47 The Authority regarded some of the assumptions relied upon by BGE(UK) as robust in the light of the explanation and evidence provided in support of them, but others not to be robust for the reasons set out above.

Evidence verifiable from its previous experience

- 4.6.48 The BGE(UK) application used Maximo and the Component Unit cost approach, based on evidence gained from its own experience of developing high pressure

¹⁹⁵ BGE (UK) Unconnected Gas to the West Operational Business Plan, p. 168.

¹⁹⁶ Applicant Information Pack, paragraph 3.27 – 3.30.

pipelines in a similar context to the G2W project.

4.6.49 The Authority regarded this as a robust use of previous experience.

Identification and quantification of risk

4.6.50 The BGE(UK) application specifically referenced the risk of deviations between spot estimates of the cost of debt and longer term trends¹⁹⁷. It recognised that the cost of debt proposed in the application may be different from the cost of debt that can be raised in the future if markets change significantly. However, there was no discussion of the quantification of this risk.

4.6.51 There was also reference in the application¹⁹⁸ to risks relating to issues with the route and location of the pipeline. Again, BGE(UK) provided no quantification of these risks nor any suggestion as to approaches that might be taken towards their mitigation.

4.6.52 The Authority considered that both of the risks noted above were appropriately identified, but neither of them was quantified in terms of probability or impact

4.6.53 Overall the Authority considered the identification and quantification of risk to be limited. The Authority would have expected the application to directly address the risks of each cost line with consideration given to the likelihood and impact of the risks and some discussion on possible mitigation measures in each case.

Efficiency improvement plan

4.6.54 Some evidence of past efficiency improvement was presented, e.g. the Networks Transformation Programme. There was reference¹⁹⁹ to using Maximo to reduce costs, as well as general approaches to cost management²⁰⁰, and a discussion of benchmarking²⁰¹ and how it is used to drive continuous improvement. This latter discussion included reference to examples that had resulted in efficiencies and which could be applied in Northern Ireland. BGE(UK) also provided information on design optimisation and highlighted potential benefits including

¹⁹⁷ BGE (UK) Unconnected Gas to the West Operational Business Plan – p. 169.

¹⁹⁸ BGE (UK) Unconnected Gas to the West Operational Business Plan – p. 146.

¹⁹⁹ BGE (UK) Unconnected Gas to the West Operational Business Plan – p. 94.

²⁰⁰ BGE (UK) Unconnected Gas to the West Operational Business Plan – p. 146

²⁰¹ BGE (UK) Unconnected Gas to the West Operational Business Plan – p. 155.

increased capacity and reducing distribution costs.

4.6.55 The Authority therefore considered that there was some evidence of efficiency improvement in the application. However, some of the examples given represent no more than good practice (e.g. using efficient boilers) and no quantification of benefits attaching to them was given.

4.6.56 In the absence of an explicit efficiency improvement plan, and given the limited value of the examples of past efficiency improvement provided, the Authority considered that this element of the application was very weak, with no evidence presented of specific plans or programmes to improve the efficiency of operation of a high pressure pipeline.

Final mark for sub-criterion 3.17(b)

4.6.57 Having regard to the OBP and in particular to the matters identified above, the Authority considered that the BGE(UK) application should attract a low score, and its final decision is to award 9 out of 20 marks, in relation to sub-criterion 3.17(b).

4.6.58 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.

4.6.59 When compared with the other applications, the Authority considered that the BGE(UK) application was inconsistent in quality. The information and evidence presented in support of the WACC was reasonable overall; the methodology was sound and the data sources used generally reliable. However, there were areas in which it could have been fuller and more detailed. This part of the application was good in comparison to PNGL, but less clear and comprehensive than NIEH. In relation to capital expenditure the application was weak, with limited detail and at least one apparent error. The overall mark reflected the medium quality of the WACC analysis adjusted by the clearly low quality description relating to capital expenditure.

4.7. Specific Criteria – Operational Business Plan 3.17(c)

- 4.7.1 The experience of the applicant and others on whom it intends to rely in relation to network construction
- 4.7.2 BGE(UK) stated that it intends to rely on experience from within the BGE group, including its own subsidiary Bord Gais Networks, in the construction of the high pressure network, and only employ an outsourcing model for certain activities²⁰².
- 4.7.3 The OBP contained details of previous experience within the BGE group of building and operating high pressure pipelines in both Northern Ireland and the Republic of Ireland²⁰³. BGE(UK) itself has constructed 300km of high pressure pipelines in Northern Ireland and is currently in the construction management phase of a number of 70 barg pipelines in the Republic of Ireland. BGE(UK) stated that these pipelines have been constructed within programme time and budget²⁰⁴.
- 4.7.4 The Authority noted that BGE(UK) is a subsidiary of BGE, which owns and operates the high pressure gas network in the Republic of Ireland. This consists of over 2,400km of high pressure (>19bar) pipelines including around 400 km of subsea interconnectors to Scotland.²⁰⁵
- 4.7.5 BGE(UK) indicated that it would avail of the construction experience elsewhere within BGE for the project²⁰⁶. The Authority considered this to be a reasonable and credible proposal.
- 4.7.6 Overall, the Authority considered that BGE(UK) had demonstrated a significant degree of relevant experience, both from within its own resources and those of its wider group, on which it will be able to draw in relation to managing the processes and resources necessary to construct a high pressure network.
- 4.7.7 The Authority also noted that BGE(UK) has in place a number of framework agreements which cover services relevant to network construction, such as

²⁰² Ibid. p. 25 and table 6 at pp. 56 – 57.

²⁰³ Ibid, table 2 at pp. 33 – 35.

²⁰⁴ Ibid, p.29.

²⁰⁵ Ibid, p.25.

²⁰⁶ Ibid, p23.

engineering services and land agency. The Authority cannot directly assess the skills and experience of the bodies with which BGE(UK) has such arrangements. However, it considered that the internal experience upon which BGE(UK) can draw in relation to the construction of high pressure networks indicates that such arrangements, managed by experienced internal staff, are an appropriate means of supplementing that experience where necessary.

The experience of the applicant and others on whom it intends to rely in relation to network construction

- 4.7.8 BGE(UK) provided information in its OBP with regard both to its own experience of high pressure network operation and to that within the wider BGE group.
- 4.7.9 In Northern Ireland, BGE(UK) operates the North West Pipeline which takes the form of a 450mm pipeline which became operational in 2004, extending 112km from Carrickfergus to supply the power station at Coolkeeragh. It also operates the South-North Pipeline which became operational in 2006 and is a 156km long pipeline extending from the landfall of the gas interconnector at Gormanston, Co. Meath, in the Republic of Ireland to Ballyalbanagh on the North West Pipeline²⁰⁷.
- 4.7.10 BGE(UK) referred to what it described as an exemplary safety record in high pressure pipeline construction and operation resulting from its competence, capability, and experience in the industry²⁰⁸.
- 4.7.11 The OBP indicated that BGE(UK) has an existing central control room operation and drew attention to its management of the gas supply and demand on the current Northern Ireland pipeline network during the record winter cold weather periods experienced in 2009/2010. BGE(UK) stated that during this period no interruptions in gas supplies were experienced by Northern Ireland customers and record gas flows were transported through the Beattock Compressor Station. It asserted that this indicates that the control room will be capable of monitoring and supervising the high pressure pipeline which is the subject of the licence.
- 4.7.12 The OBP stated that installations on the high pressure pipeline will be monitored

²⁰⁷ Ibid, p. 21.

²⁰⁸ Ibid, p. 23.

via remote telemetry at BGE(UK)'s Grid Control Centre, where any deviation from the standard operating parameters may be detected and result in a call out of the local BGE(UK) operations personnel. It proceeded to provide details of BGE(UK)'s existing SCADA²⁰⁹ system.

- 4.7.13 In addition to SCADA, BGE(UK) provided information to illustrate that it has other IT systems necessary to operate the network; these include GTMSNI²¹⁰, asset management and cathodic protection remote monitoring systems²¹¹. BGE(UK) stated that the new licensed area will leverage off these existing systems²¹², and that it has contracts in place for maintenance services which can, with minor amendments, be extended to cover the new licenced area²¹³.
- 4.7.14 The OBP indicated that BGE(UK) assumes it will be operating its existing high pressure networks under the single Northern Ireland network code. BGE(UK) is already a party to the Northern Ireland Network Operators Agreement, which it assumes would be a requirement for the holder of the licence.
- 4.7.15 BGE(UK) stated that, in carrying out its current network operation in Northern Ireland, it utilises the services of both Bord Gais Networks and BGE group and that BGE(UK) similarly proposes to rely on the services of Bord Gais Networks to deliver the G2W project²¹⁴.
- 4.7.16 The OBP contained further information on Bord Gais Networks' experience of high pressure network operation in the Republic of Ireland²¹⁵.
- 4.7.17 Overall, the Authority considered that BGE(UK) had provided comprehensive and detailed information, with appropriate supporting evidence, to demonstrate its own experience in operating high pressure networks and the experience of the wider group on which it is able to draw.

²⁰⁹ Supervisory Control and Data Acquisition.

²¹⁰ The Gas Transportation Management System Northern Ireland provides functionality for capacity booking, shippers, nominations, allocations, balancing, scheduling, shrinkage and billing.

²¹¹ BGE(UK), op cit, p.48.

²¹² Ibid.

²¹³ Ibid, section 6.3.2.

²¹⁴ Ibid, p. 25.

²¹⁵ Ibid, p. 29

4.7.18 This conclusion was supported by the advice received from Rune²¹⁶.

Securing, mobilisation and management of resources

4.7.19 BGE(UK) provided detailed proposals in relation to how it would seek to secure, mobilise and manage the internal and external resources necessary for the construction of the network.

4.7.20 As noted above, in relation to internal resources, BGE(UK) indicated that it intends to rely on the services of its subsidiary Bord Gais Networks to deliver the project. Resources for construction would be sourced via the BGE group.

4.7.21 In relation to external resources for the construction of the network, BGE(UK) stated that, if EU procurement requirements do not apply, it will use its existing pre-approved suppliers. Otherwise it stated that BGE(UK) and BGE have many of the contracts needed currently in place; for example, BGE(UK) would utilise its existing framework agreements for materials²¹⁷ and strategic contracts under its framework agreements in relation to engineering works and services²¹⁸ and for specialist services²¹⁹.

4.7.22 BGE(UK) stated that an Executive Steering Group led by the BGE(UK) chairman has been established for the G2W project and an initial team had undertaken consultation with key stakeholders including firmus energy²²⁰. BGE(UK) stated that, drawing on past experience, it intends to establish a project team which will be similar to the project team that delivered the North West, South-North and Kernan to Derryhale pipelines²²¹.

4.7.23 BGE(UK) proposed that a single project team will be established with firmus, an approach that has proved successful in the past. Detailed information was provided regarding what BGE(UK) claimed would be the potential areas of significant benefit arising from this arrangement, for both the high pressure and

²¹⁶ Rune Associates, op cit, p.7.

²¹⁷ BGE(UK), op cit, p.131.

²¹⁸ Ibid, p.134.

²¹⁹ Ibid, p.136.

²²⁰ Ibid, p. 29.

²²¹ Ibid.

- low pressure networks, in terms of delivery and costs²²².
- 4.7.24 Organisational arrangements for the project team were described in the OBP with roles clearly indicated²²³. BGE group functional support was also identified²²⁴ as were key personnel²²⁵.
- 4.7.25 BGE(UK) also provided information on its existing range of information systems which were developed to support the construction, operation and maintenance of other high pressure networks. It stated that it is intended that these systems will be utilised in relation to the high pressure network; BGE(UK) and Bord Gais Networks already having existing systems in place such as Maximo and GTMS. These are used in the Republic of Ireland and Northern Ireland and BGE(UK) stated that it does not envisage the need for any new systems²²⁶.
- 4.7.26 Overall, the Authority considered that BGE(UK) had provided comprehensive and detailed information, with appropriate supporting evidence, to demonstrate the appropriateness of its proposals to secure, mobilise and manage the internal and external resources necessary to construct the network.
- 4.7.27 This conclusion was supported by the advice received from Rune²²⁷.

Engagement with stakeholders

- 4.7.28 As noted above, the Authority considers there to be substantial overlap between sub-paragraphs 3.17(a)(i) and 3.19(g) of the Criteria. The Authority's analysis of BGE(UK)'s application under sub-paragraph 3.17(a)(i) is therefore of relevance and is adopted as part of its assessment here.
- 4.7.29 BGE(UK) provided a comprehensive stakeholder engagement plan broken down into six stages from an initial stakeholder liaison and scoping exercise to a final learning and evaluation phase²²⁸. The plan was based on previous experience, in Northern Ireland and the Republic of Ireland, and set out the relationships that BGE(UK) has already established through its existing business in Northern

²²² Ibid.

²²³ Ibid, p. 30.

²²⁴ Ibid. p. 43.

²²⁵ Ibid, appendix A.

²²⁶ Ibid, p. 48.

²²⁷ Rune Associates, op cit, p.9 and pp. 13-14.

²²⁸ Ibid.

Ireland.

- 4.7.30 As noted in Chapter 2 of the provisional decision, sub-paragraph 3.19(g) contains a degree of specificity which is not contained in sub-paragraph 3.17(a)(i), as it refers to proposals in relation to particular groups of stakeholders which the latter does not. Those groups are identified as 'all relevant regulatory authorities and statutory agencies, other licence holders and private entities necessary to construct a high pressure network'.
- 4.7.31 With regard to relevant regulatory authorities and statutory agencies, BGE(UK) listed previous relationships with the Northern Ireland Road Authority, the Utilities Committee of the Department of Regional Development, and the Centre for Protection of National Infrastructure²²⁹, and stated that it will engage frequently with Department of Regional Development²³⁰. It also stated that it has already held meetings with the Environment Agency.²³¹
- 4.7.32 The Authority considered that BGE(UK) has demonstrated an appreciation of the relevant regulatory authorities and statutory agencies which would be involved in the construction of the network. When therefore it states later in its OBP that, as part of its stakeholder engagement plan, it will liaise with statutory bodies the Authority had confidence that it has a clear understanding of who the relevant bodies are.
- 4.7.33 BGE(UK) has also demonstrated its consideration of other licence holders through its reference to its existing relationships with other licence holders such as Premier Transmission Limited (PTL), Phoenix Natural Gas, firmus energy²³².
- 4.7.34 As explained above, the Authority considers landowners to be the key private stakeholder in regard to the construction of the high pressure network. BGE(UK) demonstrated that it understands the particular importance of engagement with landowners, has experience of such engagement, and has a plan for interactions with them. One example of the way in which this is signalled in its application

²²⁹ Ibid, section 3.6.1.

²³⁰ Ibid.

²³¹ Ibid.

²³² Ibid.

was through the inclusion of its 'Landowners Handbook'²³³.

- 4.7.35 Overall, the Authority considered that, through its stakeholder engagement plan and examples of previous relevant experience of stakeholder engagement in Northern Ireland, BGE(UK) had demonstrated that it has established plans for stakeholder engagement that are comprehensive, detailed and appropriate.

Timely delivery of the high pressure network

- 4.7.36 In section 3.1 of its OBP, BGE(UK) outlined detailed proposals for the timely delivery of the high pressure network based on its previous experience in undertaking the construction of other similar networks. In appendix B, BGE(UK) also provided detailed project plan diagrams which included estimated durations for more than 110 discrete activities as part of the construction project. The OBP additionally provides detailed information defining the planned activities.
- 4.7.37 Although BGE(UK) provided a project plan based on a three year timescale for network delivery, it stated that based on its experience a timescale of four years may be more appropriate²³⁴ and so provided project plan diagrams on that basis. However, the Authority noted that the advice from Rune concludes that the proposed programme for completion within three years is inherently credible²³⁵.
- 4.7.38 The Authority noted that the BGE(UK) plan²³⁶ indicated a start date in 2015 despite the Authority stating that the licence was proposed to be awarded in October 2014²³⁷. The reason for this proposed delay following the award of the licence was not explained, and it was unclear whether it reflected an assumption by BGE(UK) that the timetable for licence grant was likely to change, or whether it represented a window that BGE(UK) wished to have between licence grant and the commencement of activities. If the latter, the Authority considered that it could involve an unnecessary period without activity, with consequential effects on the overall delivery of the plan. However, it did not regard this issue as having material weight in its overall assessment.

²³³ Ibid, Appendix C.

²³⁴ Ibid, section 3.1.1.

²³⁵ RUNE Associates, op cit, p.17.

²³⁶ Ibid, Appendix B,

²³⁷ Paragraph 4.48 of the Applicant Information Pack.

- 4.7.39 BGE(UK) provided information as to how it proposes to manage risk as part of the project. The Authority recognised that this is an important aspect of timely delivery. BGE(UK)'s management of risk is discussed above under sub-criterion 3.17(a), and the Authority's conclusion that the approach to risk described was robust is relevant and adopted here.
- 4.7.40 In its assessment of the matters arising under this heading the Authority also had regard to BGE(UK)'s proposal to substitute high pressure pipelines with low pressure pipelines. The report from Rune advised that this proposal was credible but that no evidence was provided of a high level cost benefit analysis. Rune also concluded that the twelve bar minimum pressure option had not been well-explained and Rune could not view it as credible²³⁸. The Authority concluded that this proposal would not have a material impact on the timely delivery of the pipeline in light of the other detailed evidence provided by BGE(UK).
- 4.7.41 Overall, the Authority concluded that BGE(UK) can draw upon very significant experience in the construction of high pressure pipelines and therefore has a clear understanding of the activities involved in delivering such projects. The Authority considered that BGE(UK)'s proposed programme for construction and commissioning of the pipeline over a three year period was credible on the basis of both previous experience and the detailed explanation of its project plan provided in the application.
- 4.7.42 This conclusion was supported by the advice provided by Rune.²³⁹

Final score for sub-criterion 3.17(c)

- 4.7.43 In arriving at its final score for 3.17(c) the Authority considered the response made by BGE(UK) to the provisional decisions, BGE(UK) stated that it did not believe that its scoring in relation to the Operational Business Plan, when reviewed relative to that of other applicants, fully reflected the strength of its application, in particular its experience in the management of high pressure pipelines.
- 4.7.44 The Authority reviewed its scoring against the relevant Criteria for the purpose of

²³⁸ Ibid, p.14.

²³⁹ Ibid, p. 17.

reaching its final conclusions. In doing so, it noted BGE(UK)'s comments, but in the absence of any more particularised challenge to the provisional marks did not consider that there was any ground for changing those marks. See chapter 2 for more details.

- 4.7.45 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the BGE(UK) application should attract a medium score, and its final decision is to award 15 out of 20 marks, in relation to sub-criterion 3.17(c).
- 4.7.46 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them
- 4.7.47 By comparison with the other applications, as in relation to sub-criterion 3.17(a), the Authority considered that the BGE(UK) application provided strong evidence of skills and experience relating to high pressure networks (both their operation and construction). This was clearly distinguishable from the PNGL application, but similar to that of NIEH; both applicants' mobilisation proposals were robust and their submissions indicated that the systems and contracts needed were largely in place or could be extended if required. Note was taken of BGE(UK)'s proposal to substitute high pressure pipelines with low pressure pipelines, but this was less credible than PNGL's equivalent proposal, and the rationale for a 12 bar minimum pressure option was confusing and could not be understood. In the round, BGE(UK)'s submission was judged broadly equivalent to that of NIEH in respect of this sub-criterion.

4.8. Specific Criteria – Innovation & Technology

- 4.8.1 BGE(UK) addressed innovation and technology transfer in a standalone document submitted as part of its application (the ITT).
- 4.8.2 The ITT did not systematically address the matters listed in paragraph 3.21 of the Criteria. Instead it sought to demonstrate a history of innovation within the BGE group and BGE(UK), the factors driving the delivery of innovation, and outputs such as cost efficiencies.

Environmental sustainability

- 4.8.3 The ITT made reference to 'environmental tools'²⁴⁰ and the award of Business Working Responsibly Mark certification for responsible and sustainable business practices in 2013²⁴¹.
- 4.8.4 Under the heading of 'environmental tools' BGE(UK) stated that it has developed an environmental policy and has also achieved National Standard Authority of Ireland (NSAI) accreditation of Environmental Management System to I.S. EN ISO 14001:2004.
- 4.8.5 The ITT stated that this policy is implemented through techniques developed by BGE(UK) such as Envirokit and Enviroplan, and that it is currently in the process of developing Enviroops. These documents are designed to provide guidance to planning and assessment, operations, construction and office staff and will be applied to activities undertaken in respect of the licence.
- 4.8.6 As noted in Chapter 2 of the provisional decision, the Authority understands 'innovation' to mean the design or commissioning, and implementation, of genuinely new technology, methods, processes or procedures. Likewise it understands 'technology transfer' to mean the implementation of the fruits of innovation in a context other than that in which the innovation originally took place.
- 4.8.7 The Authority did not consider that BGE(UK) had provided sufficient indication that the guidance documents it describes could be regarded as being genuinely innovative in respect of environmental sustainability. Likewise, the award of the Business Working Responsibly Mark certification, while no doubt positive, is not in itself evidence of innovation of the sort that the Authority is required to assess under the ITT Criteria.

Efficiency in use of gas and new sources of gas

- 4.8.8 The ITT provided some information regarding measures to improve efficiency in use of gas, but none of the information indicated that the examples given arose

²⁴⁰ BGE(UK), *Gas to the West: Innovation and Technology Transfer*, p. 21.

²⁴¹ *Ibid*, p. 22.

from innovation on the part of BGE(UK).²⁴²

- 4.8.9 In relation to efficiency in the use of gas BGE(UK) point to the fact that the replacement of modulating boilers with modulating condensing boilers results in significant fuel and CO₂ savings as condensing boilers are approximately 90% efficient. Also that BGE are engaged in a pilot project to upgrade some boiler units with small CHP boilers which is expected to significantly reduce electrical demand at their larger installations.²⁴³
- 4.8.10 In relation to the use of new sources of gas, BGE(UK) stated that it is 'actively engaged in reviewing options for renewable gas' and that as this technology is developed it could be transferred to Northern Ireland.²⁴⁴
- 4.8.11 The Authority considered that it could give no real weight to these examples. A broad statement that BGE(UK) is reviewing options in relation to biogas is not evidence of innovation, nor is a statement that as technology develops it will be transferred to Northern Ireland evidence of technology transfer.

Cost efficiency

- 4.8.12 The ITT detailed a number of projects relevant to high pressure pipelines and provided identified cost savings in respect of some of them; for example the introduction of an in-house solution for temporary filtration for pipeline pigging which has generated cost savings of circa €1.5m over five years.²⁴⁵ BGE(UK) also point to the fact that the introduction of pre-insulated transmission pipe has resulted operational savings due to reduced repairs to pipeline coating and a reduced frequency of inspections. However, these savings have not been quantified.²⁴⁶
- 4.8.13 The Authority considered that most of the examples provided by BGE(UK) under this heading could broadly be characterised as good business practice rather

²⁴² See explanation of the Boiler replacement Programme and the introduction of combined heat and power units in *ibid*, section 3.5.1, p.16.

²⁴³ *Ibid*, p. 16

²⁴⁴ *Ibid*, section 3.5.2, p.17.

²⁴⁵ *Ibid*, section 3.1.1, p.8.

²⁴⁶ *Ibid*, p. 8.

than as evidence of innovation on the part of BGE(UK) itself. In order to assess them as innovative means of achieving cost efficiency the Authority would have required some confirmation that BGE(UK) originally developed the techniques it described. Overall, the Authority concluded that little weight could be attached to the submissions in this part of the ITT.

The development of the network to more remote geographical areas

- 4.8.14 The ITT provided a summary of how the existing gas network in Northern Ireland has developed and stated that 'BGE (UK) has worked successfully to rollout infrastructure with the Utility Regulator and will continue to meet the needs of growth to extend the gas network to the benefit of the Northern Ireland consumer'.²⁴⁷
- 4.8.15 No specific proposals for the development of the G2W high pressure network to more remote geographical areas were provided.
- 4.8.16 The Authority considered that the mere statement that BGE(UK) has delivered other networks is insufficient evidence of its ability to achieve innovation and technology transfer under this heading.
- 4.8.17 Such information is relevant to the experience on which BGE(UK) can draw in constructing and operating high pressure networks and has been credited under other headings. However, it did not signal the use of innovation and technology transfer in relation to network development in remote areas.

History of innovation

- 4.8.18 BGE(UK) cites a number of examples of previous innovation, for example²⁴⁸:
- a. the use of pre-insulated transmission pipes leading to time and operational savings in repairs to pipeline coating, which has reduced the frequency of inspections, thereby delivering a higher quality product; and
 - b. the introduction of an in house solution to temporary filtration for pipeline

²⁴⁷ Ibid, section 3.6, p. 18.

²⁴⁸ Ibid, sections 3.1.2 and 3.1.3, p. 8

pigging. BGE(UK) developed an in-house solution to the need to filter the gas at the point where the pig is extracted in advance of re-injecting it into the pipeline.

4.8.19 The Authority attached weight to these examples as demonstrations of an ability to innovate generally in relation to high pressure pipelines.

4.8.20 The Authority considered that the first of these innovations was relevant to the network which is the subject of the licence application and that the second was illustrative of an ability to innovate more generally. However, the examples were limited and it would have expected a greater effort to be made to draw out how these examples illustrated an ability to innovate in relation to the network licence to which the application relates. In consequence, only limited weight was given to these parts of the submission for the purposes of this sub-criterion.

Ability to secure funding

4.8.21 The ITT provided no information relating to BGE(UK)'s ability to secure funding from other governmental or regulatory authorities. Rune concluded in its advice to the Authority that no evidence had been provided by BGE(UK) of its ability to secure funding for innovative developments²⁴⁹.

4.8.22 The Authority therefore concluded that BGE(UK) had failed to provide any information relevant to this heading.

Transfer of innovation into Northern Ireland

4.8.23 The ITT set out no substantive proposals to transfer any innovation into Northern Ireland. This was noted in the report from Rune.²⁵⁰

4.8.24 The Authority noted that, as indicated above, BGE(UK) stated that as technology in relation to biogas is developed it 'could be transferred to Northern Ireland'.²⁵¹ However, this statement was too tentative to constitute a proposal to transfer innovation and, in any event, the innovation in relation to biogas is not described.

²⁴⁹ RUNE Associates, *Gas to the West: Technical Advice on High Pressure Submissions*, 19 June 2014, p. 19.

²⁵⁰ Ibid.

²⁵¹ BGE(UK), *Gas to the West: Innovation and Technology Transfer*, section 3.5.2, p. 17.

- 4.8.25 The Authority did not consider that the application substantially addressed the issues required to be considered by it under this heading.

Existing skills and experience

- 4.8.26 The existing skills and experience of BGE(UK)'s staff in relation to innovation were not detailed in the application. Instead, the ITT discussed BGE(UK)'s Network Transformation Programme (NTP) and BGE's competency and performance management framework.²⁵²
- 4.8.27 It was not clear from the application how either the NTP or the performance management framework drives the skills and experience needed for innovation.
- 4.8.28 As noted in Chapter 2 of the provisional decision paper, sub-paragraph 3.21(b)(iv) of the Criteria refers to 'existing skills and experience'. The Authority therefore considered that it was able to give no credit under this heading in respect of any skills or experience which may be gained by staff in the future as a result of performance management.
- 4.8.29 However, the Authority recognised that there is some overlap between this sub-paragraph and sub-paragraph 3.21(b)(i), as evidence of a history of innovation is one way in which skills and experience may be demonstrated.

Final Conclusion

- 4.8.30 The Authority considered that some credit should be given to BGE(UK) for the examples of innovation that it presented in its application. However, generally it considered that limited weight should be attached to those examples, as the ITT made little attempt to illustrate how they demonstrated skills and experience which were of relevance to innovation in the context of the G2W project.
- 4.8.31 In relation to efficiency in the use of gas, BGE(UK) provided a number of examples where engineering measures have or are expected to result in reduced fuel use: such as the pilot project to upgrade some boiler units with small CHP units.
- 4.8.32 BGE(UK) cites a number of examples of previous innovations. The Authority

²⁵² Ibid, section 2, pp. 5 - 7.

attached a weight to these examples as demonstrations of an ability to innovate generally in relation to high pressure pipelines.

4.8.33 As set out more fully in chapter 2, in arriving at its final score for 3.17(c) the Authority considered the response made by BGE(UK) to the provisional decisions. BGE(UK) stated that it did not believe its scoring in relation to Information and Technology Transfer, when viewed relative to that of other applicants, fully reflected the strength of its application.

4.8.34 The Authority reviewed its scoring against the relevant Criteria for the purpose of reaching its final conclusions. In doing so, it noted BGE(UK)'s comments, but in the absence of any more particularised challenge to the provisional marks did not consider that there was any ground for changing those marks.

Final score for the ITT criteria

4.8.35 Having regard to the application and in particular to the matters identified above, the Authority confirms that the BGE(UK) application should attract a low score, and its final decision is to award 9 out of 20 marks, in relation to the ITT Criteria, to be allocated equally between sub-criteria 3.21(a) and (b).

4.8.36 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them

4.8.37 When compared with the other applications, the Authority considered that the BGE(UK) application provided limited evidence of its ability to achieve innovation and technology transfer when set against that of NIEH. As to some of the matters to be considered by the Authority no relevant evidence was given by BGE(UK). Its application was more closely comparable to that of PNGL in respect of ITT, but attracted a slightly higher mark because some of its history of innovation had relevance to high pressure pipelines, and was therefore of greater relevance to the licence being sought.

4.8.38 In relation to efficiency in the use of gas, BGE(UK) provided a number of examples where engineering measures have or are expected to result in reduced fuel use; such as the pilot project to upgrade some boiler units with small CHP boilers.

4.8.39 Limited information has been provided in regard to the matters listed in 3.21(b), for example, BGE(UK)'s ability to secure funding has not been addressed. Proposals to transfer innovations into Northern Ireland are limited and the existing skills and experience of BGE(UK)'s staff in relation to innovation are not detailed. (BGE(UK) cites a number of examples of previous innovation. The Authority attached weight to these examples as demonstrations of an ability to innovate generally in relation to high pressure pipelines.

4.9. Resources Criteria

4.9.1 Having carried out a detailed analysis of the BGE(UK) application, and in particular considered the OBP for the purpose of awarding marks under sub-criteria 3.17(a) to (c), the Authority then considered whether BGE(UK) meets each of the Resources Criteria.

4.9.2 As described in Chapter 2 of the provisional decisions, and for the reasons set out there, this entailed taking the Resources Criteria out of the formal sequence in which they appear in the Criteria, and considering them as a final check on the application as a whole; following, and drawing on the detail, of the analysis of the OBP.

4.9.3 On this basis, for the purposes of these two criteria, the Authority carried out an overall assessment of the information and evidence that was revealed by the BGE(UK) application in relation to the adequacy of its resources.

4.9.4 More specifically, the Authority:

- a. considered carefully whether BGE(UK) has demonstrated that it has, or is making appropriate arrangements to obtain, the resources required to meet the obligations to be included in the conditions of the high pressure licence (the Adequate Resources Criterion); and
- b. considered in particular whether BGE(UK) has demonstrated that it has the resources and financial standing to undertake the activities to be carried out for the purposes of meeting those obligations (the Financial Resources and Standing Criterion).

4.9.5 For these purposes, the Authority had particular regard to whether BGE(UK) has

demonstrated that it will have the financial resources for the construction of the high pressure network while being subject to a revenue restriction that reflects the financial terms of its application. This will constitute the most substantial obligation of any applicant which is successful in obtaining the licence.

Assessment following sub-criteria 3.17(a) to (c)

- 4.9.6 In carrying out this assessment, the Authority began with the marks awarded by it in relation to sub-criteria 3.17(a) to (c).
- 4.9.7 As indicated above, BGE(UK) was awarded a 'high' score in respect of sub-criterion 3.17(a), a 'medium' score (at the top end of that range) in respect of sub-criterion 3.17(c), and a 'low' score (at the top end of that range) in respect of sub-criterion 3.17(b).

Sub-criteria 3.17(a) and (c)

- 4.9.8 As explained in Chapter 2 of the provisional decisions, where an applicant is awarded marks which fall within the medium to high parts of the range, it might be expected that its application would reveal a broad adequacy of resources for the purposes of the licence.
- 4.9.9 Sub-criteria 3.17(a) and (c) are essentially concerned with the assessment of the application in relation to what the Adequate Resources Criterion describes as 'systems and apparatus' and 'human and other resources'.
- 4.9.10 In respect of these sub-criteria, BGE(UK) is awarded, once the marks were given their appropriate weighting for the purpose of the Best Value Criterion, 81% of the available marks.
- 4.9.11 This is consistent with what was anticipated in Chapter 2 of the provisional decisions, and what was in fact found by the Authority on its assessment of the relevant parts of the OBP, which is that these scores reflect the final conclusions by the Authority which reveal a broad adequacy of the relevant resources on the part of BGE(UK).
- 4.9.12 The Authority's assessment of the quality of information and evidence submitted in the relevant parts of the OBP is set out above, and need not be repeated here in full.

- 4.9.13 In summary, what the Authority identified was that BGE(UK), with its experience of constructing and operating high pressure networks in Northern Ireland, had produced clear and detailed evidence that it either has, or is making appropriate arrangements to acquire, the systems, apparatus, human and other resources required for the purposes of the G2W high pressure licence.

Sub-criterion 3.17(b)

- 4.9.14 As explained in Chapter 2 of the provisional decisions, where an applicant is awarded marks which fall within the low part of the range, that is likely to call into question whether its application reveals an adequacy of resources and therefore requires careful further analysis.
- 4.9.15 In respect of the financial information and evidence considered under sub-criterion 3.17(b), BGE(UK) obtained 45% of the available marks. This was at the top end of the 'low' range, but it nonetheless requires questions to be asked about whether BGE(UK) has access to the financial resources it requires for the purposes of both the Adequate Resources Criterion and the Financial Resources and Standing Criterion.
- 4.9.16 In considering this matter, the Authority noted that the BGE(UK) score in relation to sub-criterion 3.17(b) mainly reflected the incompleteness and lack of detail in elements of its description of the how the data in the Data Input Workbook were derived. Elements of the description were sound and well-evidenced, but others were not complete or only inadequately evidenced. In relation to some data, no supporting information was provided, and there were indications of potential errors.
- 4.9.17 This inconsistency in the quality of the submission is reflected in a final mark which rates this part of the application as close to, but still falling short of, the medium range.
- 4.9.18 For the purposes of the Resources Criteria, the Authority considered that there were two mitigating aspects to the overall low score.
- 4.9.19 First, the more complete element of this part of the BGE(UK) application related to its description of how the WACC was derived. The Authority considered this to be broadly reasonable, although lacking in some detail and capable of having

been improved. The weaker aspect of the application related to the description of the capital expenditure data.

- 4.9.20 For the purposes of assessing whether BGE(UK) has, or will be able to obtain, the required financial resources, it is the WACC figure which is most important.
- 4.9.21 Second, the Authority considered, for the purpose of testing the assumptions made by BGE(UK), whether its proposed WACC of 6.09% was such that it would be able to raise the finance required to construct and operate the high pressure network while subject to a revenue control condition embodying that WACC. The Authority concluded that this was a robust assumption, and indeed that it had no concerns about the ability of BGE(UK) to finance its activities under the high pressure licence on the basis of the proposed WACC.
- 4.9.22 The reasons for this are described above. In short, they are as follows:
- a. The WACC falls within NERA's plausible range.
 - b. The WACC lies at the very top of that range. Because it is included in the Data Input Workbook it influences the calculation of the marks awarded to BGE(UK) for the Applicant Determined Costs sub-criterion, and because it is comparatively high it will for that reason be adverse to BGE(UK) in that context. However, for the purposes of the Resources Criteria a high WACC raises fewer concerns than a low one, since it is reflective of a cost of debt and equity that would be likely to attract investors.
 - c. In any event, BGE(UK) intends to finance the project through corporate finance, has evidenced by reference to its financial statements and access to finance facilities that it has the resources, and has already received the approval of its Board of Directors to fund the project.
- 4.9.23 In addition BGE(UK) has provided historical evidence of having raised finance for the construction of high pressure pipelines in Northern Ireland.
- 4.9.24 Taking all of these points together, the Authority's final conclusion is that the factors which led BGE(UK) to receive a low score in relation to sub-criterion 3.17(b) are not ones which in fact serve to call into question whether it has the requisite financial resources to undertake the licensed activities.

Final Conclusion

- 4.9.25 On the basis of the information and evidence provided to it in the BGE(UK) application, the Authority had no reason to question that BGE(UK) will have the non-financial resources that it requires for the purposes of the high pressure licence. Those matters are well-evidenced.
- 4.9.26 The Authority did consider whether the weaker elements of BGE(UK)'s OBP in relation to the data in its Data Input Workbook called into question whether it has or can obtain the financial resources required for the purposes of the licence, but concludes that, for the reasons given above, they do not.
- 4.9.27 Therefore, the Authority concludes that BGE(UK):
- a. has demonstrated to its satisfaction that it either currently has, or is making appropriate arrangements to ensure that it would have in place by the time it would commence regulated activities under the high pressure licence (if granted), the financial and other resources likely to be sufficient for the purposes of meeting its obligations under the conditions of that licence; and,
 - b. has demonstrated that it has the resources and financial standing to undertake the activities to be carried out for the purposes of meeting those licence obligations.
- 4.9.28 In consequence the Authority's final conclusion is that BGE(UK) meets both of the Resources Criteria.

5.0 NIEH High Pressure Connected

5.1. Introduction

5.1.1 This chapter:

- a. considers the application made by Northern Ireland Energy Holdings Limited (**NIEH**) for the high pressure licence, which is connected to the application by Scotia Gas Networks (Northern Ireland) Limited (SGN) for the low pressure licence;
- b. the responses received to the consultation on the provisional decisions, as these relate to the connected application made by NIEH
- c. sets out the Authority's final conclusions as to whether NIEH has met each of the criteria other than the Best Value Criterion;
- d. sets out the Authority's final assessment of the marks to be awarded to NIEH in respect of the different elements of the Best Value Criterion;
- e. explains the reasons of the Authority for its final conclusions and marks.

5.1.2 In this chapter, the criteria have been addressed in the order in which they are set out in Chapter 2 of the provisional decisions, and the Authority has followed the approach to interpreting and applying the criteria that is set out in that chapter.

5.2. The Information Criterion

5.2.1 Both an electronic and a printed copy of the NIEH application were received by the Authority before the deadline of noon on 6 May 2014.

5.2.2 Once the deadline had passed the application was opened and checked for completeness against a pre-prepared checklist. The application was assessed as being complete except in three respects:

- a. it was not clear from the application what information was being relied on by NIEH for the purposes of meeting the Adequate Resources Criterion;
 - b. it was not clear from the application what information was being relied on by NIEH for the purposes of meeting the ITT sub-criteria; and
 - c. there was no clear statement of whether the application was being made for a 'cost pass through' or 'revenue cap' high pressure licence²⁵³.
- 5.2.3 NIEH was informed of these apparent omissions and was given until noon on 14 May 2014 to provide the missing information. A response was received by the deadline and it was subsequently judged that this addressed the omission in full²⁵⁴.
- 5.2.4 Having considered these facts, the Authority concluded that NIEH has provided all the information requested by the Authority, in such manner and by such times as was specified, and therefore meets the Information Criterion.
- 5.2.5 NIEH is a limited company with its registered office in Northern Ireland. NIEH's constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations²⁵⁵.
- 5.2.6 Having considered this evidence, the Authority was satisfied that NIEH has demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.

5.3. The Constitution Criterion

- 5.3.1 NIEH is a limited company with its registered office in Northern Ireland. NIEH's constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations²⁵⁶.
- 5.3.2 Having considered this evidence, the Authority was satisfied that NIEH has

²⁵³ Applicant Information Pack paragraph 4.41.

²⁵⁴ Document.

²⁵⁵ FINAL APPLICATION FORM.

²⁵⁶ FINAL APPLICATION FORM

demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.

5.4. The Fit and Proper Person Criterion

- 5.4.1 Evidence to demonstrate that NIEH is a fit and proper person was provided to the Authority in accordance with paragraphs 20 to 26 of Schedule 2 to the Application Regulations²⁵⁷. It consisted of a signed statement by a senior officer of NIEH to the effect that NIEH had no information to disclose under any of those paragraphs.
- 5.4.2 The Authority noted that NIEH has no record of enforcement action being taken against it, or any other adverse factor of the type listed in the Application Regulations.
- 5.4.3 On the basis of the evidence provided to it, the Authority was therefore satisfied that NIEH meets the Fit and Proper Person Criterion.

5.5. Specific Criteria – Operational Business Plan 3.17(a)

Engagement with stakeholders

- 5.5.1 NIEH outlined its proposals in relation to stakeholder engagement in both the pre-construction, construction²⁵⁸ and post-construction²⁵⁹ phases of the G2W project. These proposals were based on NIEH's previous experience.
- 5.5.2 Tables set out in the OBP²⁶⁰ provided a comprehensive list of the stakeholders which NIEH had identified as relevant in the pre-construction and construction phases. With respect to each identified stakeholder, the tables outlined the high level messages and rationale for engagement and a high level description of the channels through which such engagement will take place. The equivalent table

²⁵⁷ FINAL APPLICATION FORM

²⁵⁸ Section 3.6.1 of the OBP

²⁵⁹ Section 7.2 of the OBP

²⁶⁰ Tables 3.6.1a and 3.6.1b

in respect of the post-construction phase provided similar information.

- 5.5.3 NIEH stated that the communications strategy which would underpin its engagement would be based on the key principles of (i) openness, transparency and responsiveness, (ii) continuous engagement and meaningful consultation, and (iii) clear, relevant and timely communication with stakeholders. It then proceeded to unpack these principles at a high level²⁶¹.
- 5.5.4 NIEH also highlighted its considerable experience of communications relating to major energy project developments and track record of stakeholder engagement in respect of related activities. It pointed to its recent success in securing planning permission and other key permits for a major gas storage facility in Islandmagee, County Antrim as an example of a situation in which its approach to stakeholder engagement had worked well.
- 5.5.5 NIEH demonstrated its understanding that landowners are a key stakeholder in the process of pipeline construction. It stated that landowners are perhaps the most important project stakeholders and that therefore all landowners are to be engaged individually face-to-face by project officers and provided with a detailed explanatory brochure²⁶². NIEH stated that it intended to stage exhibitions in selected population centres along the pipeline route to give information about the preferred pipeline route and the planned timetable for construction.
- 5.5.6 In addition NIEH described specific work-related engagement with the system operator²⁶³, the Authority²⁶⁴, ENTSO-G and ACER²⁶⁵, the HSE²⁶⁶, shippers²⁶⁷ and the emergency services²⁶⁸.
- 5.5.7 The Authority considered that NIEH had identified a comprehensive range of key stakeholders, and had provided appropriate information concerning how it would engage with each identified stakeholder, together with a description of the high level principles that would govern that engagement.

²⁶¹ NIEH, *Operational Business Plan*, section 3.6.1.

²⁶² Ibid, table 3.6.1a.

²⁶³ Ibid, sections 3.7 and 5.4.

²⁶⁴ Ibid, section 4.2.

²⁶⁵ Ibid, section 5.4.

²⁶⁶ Ibid, section 5.1.

²⁶⁷ Ibid, section 5.4.

²⁶⁸ Ibid, section 5.8.

- 5.5.8 The Authority noted that NIEH had sought to identify experience of stakeholder engagement as evidence of its ability to deliver effective engagement in practical situations. In addition, the Authority considered that NIEH had demonstrated an appropriate understanding of the particular importance of the key stakeholder group of landowners.

Skills and experience of key members of staff and any other persons

- 5.5.9 NIEH already operates both the SNIP subsea pipeline and BGTL²⁶⁹ pipeline. It stated that it intends to rely mainly on the skills and experience of staff within its own organisation in relation to the operation of the high pressure network; the operation of the network would be an extension of its current activities, rather than new activities requiring the creation of resources. NIEH clearly set out the qualifications and experience of named key internal personnel²⁷⁰.
- 5.5.10 NIEH stated that it proposed to rely on the skills and experience of staff within SGN in relation to the construction of the pipeline²⁷¹, through the joint venture (JV) arrangement which it has in place with SGN²⁷².
- 5.5.11 The OBP²⁷³ set out SGN's experience in relation to constructing high pressure pipelines, of which it has built 120km, although none are in Northern Ireland. The qualifications and experience of named key personnel within SGN were clearly provided²⁷⁴.
- 5.5.12 NIEH stated that construction would be led by a highly experienced, although unnamed, Major Construction Project Manager employed by SGN, reporting to an SGN First Report: Head of Major Projects. The Construction Project Manager would lead the Construction Project Team (CPT), supported by appropriate Contract Management and Project Managers to enable the efficient and timely delivery of the new network. It was stated that SGN would appoint up to five

²⁶⁹ Belfast Gas Transmission Ltd.

²⁷⁰ Ibid, section 2.3.2.

²⁷¹ Ibid, section 2.1.2.

²⁷² Ibid, section 2.1.1. JV partner staff are outlined in section 2, with the structural arrangements of the JV in section 2. Section 2.3 contains the CVs of the JV partner staff and contractors secured to provide a range of specialist services. The IT resources are referred to in section 4.5.

²⁷³ Section 2.1.3

²⁷⁴ Ibid, section 2.3.2.

Project Supervisor/Officers (one per pipeline section) to support the Construction Project Manager and to manage the Major Works Contractors²⁷⁵.

- 5.5.13 In addition, NIEH stated that SGN currently has a portfolio of specialist services framework contracts capable of being utilised to supply the various skilled and experienced personnel to populate the required CPT. NIEH stated that this will provide options in letting this work either to a single contractor or a controlled number of contractors, with tangible benefits in management, known capability, competence and performance, the availability/mobilisation of the appropriate resource, familiarity of the SGN requirements and a consistent approach²⁷⁶.
- 5.5.14 The OBP²⁷⁷ clearly set out the roles which would be required for the construction of the pipeline, together with an indication of how such roles would be filled. In relation to those roles which would require recruitment, annex 1 to the OBP set out the role descriptions which SGN uses in such recruitment exercises.
- 5.5.15 The Authority considered that NIEH had provided detailed evidence that many of the staff with the skills and experience required to carry on the operation of the G2W high pressure network are already in place within the organisation, and that it has extensive relevant experience of the operation of similar high pressure networks in Northern Ireland.
- 5.5.16 In relation to the construction of the high pressure pipeline, the Authority noted that NIEH did not have such experience within its own organisation but would be reliant on its JV agreement with SGN to access the skills and experience of SGN staff.
- 5.5.17 The Authority was satisfied in principle that, where an applicant lacks the skills and experience to meet some of the obligations under the conditions of the high pressure licence, a contractual joint venture with an organisation possessing the relevant skills and experience was an appropriate means by which the required resources could be accessed. The Authority noted that NIEH stated that its JV with SGN was already established, and that this was reflected in the fact that the organisations had made connected applications for the high and low pressure

²⁷⁵ Ibid, section 2.1.2.

²⁷⁶ Ibid.

²⁷⁷ Figure 2.4b

licences.

- 5.5.18 The Authority considered that NIEH had provided clear evidence that staff with the skills and experience required to carry on the construction of the pipeline are already in place within SGN, which is an organisation with relevant experience of undertaking similar activities.
- 5.5.19 While it was not clear whether the named individuals whose curricula vitae were provided would necessarily constitute the leadership of the CPT, the Authority considered that it was clear from the evidence provided by NIEH that suitable staff to fill such roles would be available to it from the pool of staff within SGN.
- 5.5.20 In relation to skills and experience to be acquired from external contractors, the application set out the range of framework contracts which SGN already has in place and can use to access external resources where these are needed for the purposes of the CPT, and the Authority considered that it gave a good indication of what roles would require to be filled and what the process would be for filling them. The Authority considered that these were appropriate arrangements to ensure that such external resources as are needed can be procured.

Management of risk

- 5.5.21 In section 4.1.2 of its OBP, NIEH set out its policy and processes to identify and manage risk at board, business and project level and stated that these would be applied to activities undertaken under the high pressure licence.
- 5.5.22 NIEH indicated that it utilises an operational risk register that is structured 'on a preliminary hazard analysis technique to identify risks and assess their consequence and likelihood to their occurrence'. An operational risk register documents the controls in place or measures undertaken to manage risk, and an assessment is made on the adequacy of the controls in place to manage each particular risk. NIEH stated that mitigating actions or controls are listed in a remedial action register, which is not closed until the risk is mitigated as far as practicable.
- 5.5.23 Section 3.7.4 of the OBP indicated NIEH's intention that risk registers would be produced in respect of the overall risks relating to the project and also for each individual pipeline. The main risk register would be produced at the outset of the

project and would encompass the main risks likely to impact on the delivery or cost of the project. In relation to each risk the likelihood of its occurrence and its impact would be identified, together with a description of measures which would be pursued until the risk is appropriately mitigated.

5.5.24 Figure 3.1.1 of the OBP presented the output of an initial high level construction risk assessment, which identified risks, impacts and potential mitigation. There was also evidence elsewhere in the OBP of the application of risk management to the G2W project. For example, in relation to a risk of delays in implementation and roll out, NIEH indicated that this would be mitigated by conducting a cutover rehearsal within the pre-production environment to validate the approach and timings²⁷⁸.

5.5.25 In addition, there was evidence that NIEH understood the challenges presented by the proposed route of the pipeline. For example, it suggested²⁷⁹ leaving the construction of the final stretch of the pipeline, from Enniskillen to Derrylin, to last as it is the most technically challenging due to the existing ground conditions, high water table and constraints.²⁸⁰

5.5.26 The Authority considered that NIEH has demonstrated that it has robust systems in place for the identification and management of risks, and that it has provided some evidence that its approach to risk has been applied to identify a number of specific risks relating to the G2W project and suggest means of their mitigation.

5.5.27 This view was supported by the advice received from Rune²⁸¹.

Tendering arrangements

5.5.28 In its OBP, NIEH set out detailed information in relation to its tendering arrangements, which the Authority considered demonstrated an understanding of best practice in this regard²⁸².

5.5.29 NIEH outlined details of the policies and procedures which it has in place to

²⁷⁸ Ibid, section 3.3.2.

²⁷⁹ Ibid, section 3.6.6.

²⁸⁰ The Authority notes that in applying for the low pressure licence the applicant must assume that they will be subject to a Development Plan and that the development plan is set out in the Low Pressure Data Input Workbook. See Applicant Application Pack para 3.63 – 3.65

²⁸¹ RUNE Associates, op cit, p. 3.

²⁸² NIEH, op cit, sections 4.3 and 6.1.1 to 6.1.3.

ensure compliance with the requirements of EU procurement law, together with the procurement process that would apply to the G2W project.

5.5.30 NIEH stated that, under the terms of its JV agreement with SGN, the latter would manage the procurement of the main construction contracts. In its OBP, NIEH therefore provided an outline of SGN's procurement process and set out the financial Authority levels that were in place within SGN²⁸³.

5.5.31 Details of 13 relevant framework contracts which SGN currently has in place relevant to the G2W project were listed. These cover a wide range of activities including design, land agent services, and supply of PE pipe and materials and steel pipe and fittings²⁸⁴.

5.5.32 In addition, NIEH provided a table which listed the construction contracts which it would expect to be awarded as part of the project and, with respect to each of them, specified whether it would be tendered and, if not, its source²⁸⁵. The OBP also made reference to SGN's experience in utilising aspects of the NEC suite of contracts²⁸⁶.

5.5.33 Although it was not stated that SGN would use these framework agreements to source construction materials, NIEH stated that SGN intend to make use of them to source some of the personnel required immediately for design, technical and project services. NIEH also stated that the aerial survey would be sourced via an existing contract for expediency²⁸⁷.

5.5.34 NIEH indicated that it will extend its current services contracts where it is efficient to do so and that as part of its JV agreement with SGN a number of services will be provided by SGN for NIEH in the new licensed area on terms consistent with the contracts relating to NIEH's existing assets²⁸⁸.

5.5.35 Overall, the Authority considered that NIEH had provided clear and detailed information regarding its proposals as to the use of tendering arrangements, and that those arrangements were robust and in line with best practice. The Authority

²⁸³ Ibid, section 6.1.3.

²⁸⁴ Ibid, section 6.1.4.

²⁸⁵ Ibid.

²⁸⁶ Ibid, section 2.1.3.

²⁸⁷ Ibid.

²⁸⁸ Ibid, section 6.3.1.

noted that the proposals were largely based on existing policies and procedures within both NIEH and SGN and had therefore been used in previous projects. The Authority also noted that NIEH would be able to benefit, through its JV, from a number of relevant framework contracts which SGN already has in place.

5.5.36 This view was supported by the advice received from Rune²⁸⁹.

5.5.37 Consideration of responses to the provisional decisions on 3.17(a)As set out in chapter 2 above Mutual Energy stated that it was '*surprised that the scoring of the applicants' proposal as to the engagement with key stakeholders favoured those having constructed pipelines in Northern Ireland*', and contended that the NIEH stakeholder engagement plan was more comprehensive than that of any other applicant.

5.5.38 The Authority reconsidered this aspect of its provisional scoring in the light of the response from Mutual Energy. However, it was satisfied that its initial judgments were sound. It did not consider that they involved 'favouring' those who happen to have constructed high pressure pipelines in Northern Ireland, but rather of giving appropriate weight to experience gained by doing so, and in particular to the way in which BGE(UK) reflected the benefit of that experience in its stakeholder engagement proposals.

5.5.39 The Mutual Energy's response also made a number of points in relation to staff and which it contended the Authority had not adequately taken into consideration. Mutual Energy noted that the NIEH application identified named key individuals, and asserted that this was '*clearly superior*' to identifying a pool from which staff will be drawn. It also stated that NIEH had given a clear indication of where framework contracts would be needed.

5.5.40 For the reasons set out more fully in chapter 2 the Authority was therefore satisfied that NIEH had been given sufficient credit for these matters in its provisional conclusions and the provisional scoring, and that it was appropriate to confirm these. In particular the Authority considered that it had recognised and given credit to NIEH for providing the details of named individuals this in its

²⁸⁹ RUNE Associates, *Gas to the West: Technical Advice on High Pressure Submissions*, 19 June 2014, p. 6.

provisional conclusions²⁹⁰ as it had to the extent that other applicants were also able to name individuals²⁹¹. Similarly, the Authority noted that it had taken account in its provisional conclusions of the clarity of NIEH's position with regard to the use of framework contracts, which gave a '*good indication of what roles would require to be filled and what the process would be for filling them*'²⁹².

5.5.41 In relation to the identification and management of risk Mutual energy's response drew the Authority's attention specifically to figures 4.1.3a to 4.1.3d in NIEH's application, which it stated meet the Authority's interpretation of what is required by a good risk management plan, namely one that identifies project risks and deals with both the probability and impact of a risk occurring.

5.5.42 For the reasons set out in chapter 2 the Authority remains satisfied that it had had proper regard to the matters to which its attention was drawn by Mutual Energy, both when reaching its provisional conclusions and setting the mark which the NIEH application provisionally attracted against sub-criterion 3.17(a).

Final mark for sub-criterion 3.17(a)

5.5.43 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the NIEH application should attract a high score, and its final decision is to award 16 out of 20 marks, in relation to sub-criterion 3.17(a).

5.5.44 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.

5.5.45 By comparison with the other applications, the Authority considered that the NIEH application provided a comprehensive and well-evidenced statement of how it would carry out activities under the licence. It presented evidence of good skills and experience in relation to the operation of high pressure networks and, via a JV agreement with SGN, their construction. This was adequately reflected in its plans in relation to the G2W project, which also recognised the importance of engagement with landowners and certain features of the geography of the

²⁹⁰ Chapter 5.5.10 to 5.5.15 and 5.5.18 to 5.5.19 of the Consultation.

²⁹¹ For instance, Chapter 3.5.13 to 3.5.16 of the Consultation

²⁹² Chapter 5.5.20 of the Consultation.

route. It could be distinguished from the much weaker PNGL application on this basis. The quality of the application was close to that of BGE(UK), but NIEH was slightly less strong since it did not have the advantage of being able to draw on recent experience of building high pressure pipelines in Northern Ireland and reflect that experience in forward plans.

5.6. Specific Criteria – Operational Business Plan 3.17(b)

- 5.6.1 Table 5.6.4 below sets out the values for those cost items submitted by NIEH in its application²⁹³.
- 5.6.2 These figures cover all the relevant data that were provided by NIEH and the Authority therefore carried out its assessment for the purposes of sub-criterion 3.17(b) against NIEH's description of its derivation of those data.
- 5.6.3 The Authority divided the costs into two broad categories of WACC and Capital Expenditure. The Capital Expenditure category consisted of four separate cost lines: Design/Project Management, Contingency, Mobilisation and Other Applicant Costs. These cost lines are consistent with what the Authority stated applicants should supply in the Data Input Workbook²⁹⁴. It should be noted that the WACC figures provided by NIEH were stated to be based on a cost pass through model and therefore subject to adjustment on the basis described in section 1.4.14 above.

²⁹³ Connected HP NIEH 140502 Data Input Workbook.

²⁹⁴ To assist the applicants the Authority also provided some detail on each cost area in the Application Information Pack.

Table 5.1: NIEH High Pressure Data Input Workbook Cost Items

Cost Item	Value
Weighted Average Cost of Capital	1.98%
Design / Project Management	£3.645m
Contingency	£10.832m
Mobilisation	£0.542m
Other Applicant Costs	£0.000m

Description of the derivation of cost data

Weighted Average Cost of Capital

- 5.6.4 NERA was requested to produce a report on what it would expect to see in a well-evidenced WACC submission. The Authority substantially agreed with the assessment reflected in that report. It follows the Authority would have expected to see:
- The cost of debt set out using: (i) a benchmark gilt yield (to reflect a risk free rate) plus evidence on corporate debt spreads with market evidence provided for both; and/or (ii) direct evidence of corporate debt yields with market evidence provided. For this purpose, references to corporate debt spreads/yields should reflect companies with similar risk profiles, issuance costs should be included in the cost of debt and the treatment of inflation should be clearly explained in the derivation.
 - The cost of equity set out using CAPM and incorporating the risk free rate, equity risk premium and beta with relevant evidence provided to justify each component.
 - The proposed gearing including a discussion on the how this interacts with the risks of the project, the proposed credit rating and the cost of debt.
- 5.6.5 The NIEH application was based on a 100% debt financed model.

- 5.6.6 Five elements went to make up the WACC proposed by NIEH, and these were clearly set out clearly in Figure 10.1.1. Each element was subsequently given a clear explanation²⁹⁵, with detailed supporting evidence provided in order to justify how it had been arrived at. The application also included analysis of different possible approaches to arriving at the WACC figure. It was clearly stated²⁹⁶ that the method chosen, credit spread, reflected current market conditions for similar debt.
- 5.6.7 The description of how the WACC had been derived included detail on not only the bond yield but also upfront transaction costs and the cost of funding liquidity, which were clearly evidenced and explained²⁹⁷. This was consistent with what the Authority would have expected to see in a well-evidenced submission.
- 5.6.8 An inclusion of upfront transaction costs represents standard regulatory practice as applied by the CMA, Utility Regulator, Ofgem and Ofwat, and was considered by the Authority to be a relevant element of a comprehensive WACC proposal.
- 5.6.9 The funding costs of liquidity were clearly explained and were consistent with a 100% debt model. They provided for a cash buffer in order to reduce risk for debt providers. The Authority noted in particular the link between the funding costs of liquidity and a higher credit rating which in turn provided justification for the credit spread proposed in the application. The Authority considered this explanation detailed and persuasive.
- 5.6.10 The detailed evidence provided to justify the real yield²⁹⁸ included both short term and long term market data, and the Authority considered the analysis of data over the longer timeframe of particular assistance in understanding their derivation.
- 5.6.11 The analysis on credit spread²⁹⁹ included a detailed comparison of comparator bonds set out in a table³⁰⁰. The table clearly set out the comparator bonds used, weighted towards energy and water utilities, and explained how the final spread

²⁹⁵ Connected HP NIEH Business Plan Section 10.1.2.

²⁹⁶ Connected HP NIEH Business Plan Section p.270.

²⁹⁷ Connected HP NIEH Business Plan p.273.

²⁹⁸ Connected HP NIEH Business Plan p.272.

²⁹⁹ Connected HP NIEH Business Plan p.273.

³⁰⁰ Connected HP NIEH Business Plan p.293.

was based on an average of comparator bonds plus a premium for new issue and for an index linked bond with the figures based on expert advice.

- 5.6.12 The Authority considered that the use of similar companies' cost of debt provided good evidence to support the robustness of the figures and this was consistent with what the Authority would have expected to see in a well-evidenced submission.
- 5.6.13 However the Authority noted the term 'Additional Drawdown to Fund Working Capital'³⁰¹ that was included in the section on Total Cash Raised and Application of Funds. Although the figure does not affect the WACC this term was not clearly explained and it was uncertain to what it was referring.
- 5.6.14 Overall, the Authority considered that the application provided a comprehensive, clear and detailed explanation of how the WACC figure in NIEH's Data Input Workbook was built-up³⁰², supported by robust evidence to justify all aspects of the WACC proposed.
- 5.6.15 NERA also found that NIEH had employed a robust methodology and drawn on reliable evidence, and advised that the application was well-evidenced in this area.³⁰³

Capital Expenditure

- 5.6.16 NIEH provided an explanation for all of the cost items. However, no spreadsheet was provided to allow a detailed analysis of the figures.
- 5.6.17 In the case of Mobilisation costs, the Authority considered that the build-up of costs was described in a detailed and comprehensive way³⁰⁴.
- 5.6.18 In the case of Design/Project Management the Authority considered that the explanation of how the cost was built-up was reasonable but not comprehensive; more detail could have been provided³⁰⁵. For example there was no spreadsheet to explain the cost build up on the top of page 258, and no detail on how all the

³⁰¹ Connected HP NIEH Business Plan p.276.

³⁰² Connected HP NIEH Business Plan Section 10.1.1.

³⁰³ NERA 2.2.5 p. 8.

³⁰⁴ Connected HP NIEH Business Plan Section 3.4.

³⁰⁵ Connected HP NIEH Business Plan Section 9.2.

figures in this table were built-up. NIEH made a broad reference to more detail being provided elsewhere in the OBP³⁰⁶. However, in the absence of a precise reference, the Authority was unable to be certain to what evidence it was being directed.

- 5.6.19 In the case of Contingency, NIEH provide an explanation³⁰⁷ as to how the figure was derived, and there was some discussion about its link to risk. However, there was an absence of any detailed evidence quantifying how the risks would justify the proposed figure.

Identification and application of cost drivers

- 5.6.20 NIEH identified the cost drivers for Mobilisation in a manner that was generally clear, with legal costs being a major cost item and the number of days assumed being clearly set out³⁰⁸. However, the Authority noted that while the largest cost element of mobilisation, control room costs, was supported by some discussion of cost drivers³⁰⁹, greater detail could have been provided and a spreadsheet would considerably have improved the explanation.

- 5.6.21 For Design/Project Management a number of cost drivers were specified³¹⁰, but the Authority did not consider the data to be comprehensive; further cost drivers could have been provided to allow a fuller understanding of how the final number was arrived at.

- 5.6.22 Overall, the Authority considered NIEH to have provided good information on its cost drivers, but with some limitations. In particular, the Authority did not regard the data as comprehensive, notably in respect of Design/Project Management.

Robustness of assumptions

- 5.6.23 The Authority identified and considered a number of assumptions that appeared to have been made by NIEH when deriving the data contained in its Data Input Workbook.

³⁰⁶ Connected HP NIEH Business Plan p.258.

³⁰⁷ Connected HP NIEH Business Plan p.256.

³⁰⁸ Connected HP NIEH Business Plan p.96

³⁰⁹ Connected HP NIEH Business Plan p.94

³¹⁰ Connected HP NIEH Business Plan p.258.

The Value of the WACC

- 5.6.24 First, the Authority took it to be implicit throughout the application that NIEH had assumed it will be able to carry on the licensed activities under the high pressure licence, and to do so consistently with its obligations under that licence, on the basis of the proposed WACC. That is to say, there was an implicit assumption that NIEH will be able to raise the finance required to construct and operate the high pressure network while subject to a revenue control condition embodying its proposed WACC
- 5.6.25 For the purpose of testing this assumption, the Authority considered whether the proposed WACC fell within the range of what might reasonably be expected in the context of the G2W project. To do this, it considered the market cost of debt and equity based on advice received from NERA, which took into account in its report such costs as referenced in recent regulatory decisions³¹¹. NERA advised on what it considered to be the 'plausible range' within which it would expect any WACC for this project to lie. The Authority relied upon the advice contained in the report as establishing a range against which to test NIEH's assumption
- 5.6.26 NERA established a 'plausible range' in respect of a 100% debt-financed model of 1.07% - 2.9%³¹², and NIEH's proposed WACC was 1.98%.
- 5.6.27 The Authority took into account the lower bound for the cost of debt identified by NERA of 1.07%³¹³, but considered that this figure was too low given that liquidity reserves and transaction costs would need to be added. The Authority had regard to its own experience of previous 100% debt financed entities where similar liquidity reserves and transaction costs were needed. The Authority notes that both of these costs were included within the NIEH proposed WACC.
- 5.6.28 In support of its ability to finance the project, NIEH made reference to a SGN comfort letter, comfort letters from financial institutions, and historical evidence of raising similar finance.³¹⁴
- 5.6.29 In relation to the comfort letters, the Authority did not consider that these could

³¹¹ NERA, Gas to the West, A report for the Utility Regulator.

³¹² NERA p. 33.

³¹³ NERA, Gas to the West, A report for the Utility Regulator p33.

³¹⁴ NIEH response 13 May 2014.

be taken to represent a firm commitment to provide the required financing. The letters note that any future funding commitment would be conditional on several factors, including credit market conditions, satisfactory due diligence, the final form of the legal documents and the licence, and other factors. They are not legally binding, nor do they purport to be so. Moreover, the Authority did not understand them to entail what might in any sense properly be regarded (even allowing that they fall short of a legal obligation) as a 'firm' commitment.

5.6.30 In order to clarify whether its understanding of the status and effect of the comfort letters was correct, the Authority sought advice from both NERA³¹⁵ and the Strategic Investment Board³¹⁶. Each of them confirmed the Authority's initial view that there was significant conditionality attached to the letters, including in relation to due diligence and internal bank clearances. The Strategic Investment Board noted that while the letters 'certainly indicate willingness from the funders concerned to participate in the project', it did 'not believe that the letters can be relied upon as evidence'. The Authority accepted this advice.

5.6.31 This did not entail any conclusion that the letters of comfort were inappropriate. The Authority recognised that funding commitments are likely to be contingent on, and related to the conditions of, the licence as granted; in particular on the terms of the price control which determine the value of the income stream that can be generated by the licence holder.

5.6.32 Moreover, the Authority did not consider that there was any ground for materially distinguishing between the weight to be placed on the comfort letters provided by NIEH and those provided by some other applicants. It accepted the advice of the Strategic Investment Board in this respect.

5.6.33 However, while accepting that a comfort letter indicates a willingness on the part of the relevant funder to participate in the project, the Authority considered that no material degree of weight can be attached to such letters for the purposes of demonstrating NIEH's cost of debt.

5.6.34 Nonetheless, the Authority noted that the NIEH proposed WACC lies clearly within NERA's plausible range, and would do so even after any reasonable

³¹⁵ NERA, Gas to the West, A report for the Utility Regulator p21.

³¹⁶ Strategic Investment Board – Letter to Uregni (2).

adjustment were made to that range for transaction costs and liquidity reserves.

5.6.35 The Authority also noted that NIEH has been able to evidence a history of its experience in raising 100% debt finance in relation to gas networks, and that on the basis of its JV agreement with SGN it could indicate how finance during the construction period would be dealt with.

5.6.36 Further, the Authority considered that, as explained above, NIEH had provided a clear and comprehensive description of how its proposed WACC was derived, with good supporting evidence and analysis in relation to all the elements that went to build up the WACC, and that this provided considerable comfort as to the reliability of the figure specified.

5.6.37 Therefore, taking all of these factors into account, the Authority concluded that the assumption that NIEH would be able to obtain financing to carry on the licensed activities on the basis of the proposed WACC was robust.

Estimation of Real Yield

5.6.38 Second, NIEH used a long dated UK gilt as the basis for estimating the real yield on a risk free investment. The Authority was concerned that using the real yield on a single day, 9 April 2014, could mean that the figure was an outlier.

5.6.39 On consideration, the Authority considered this to be reliant on a robust basis of estimation³¹⁷. It noted that the general approach is standard regulatory practice, and that while a single day was identified the application provided evidence³¹⁸ that the figure was representative of recent history over a longer period.

Transaction Costs

5.6.40 Third, the NIEH proposed WACC included an adjustment of 0.35% for transaction costs associated with raising finance.

5.6.41 The Authority considered that the assumption on transaction costs seemed high given that the Competition Commission, in its recent determination on Northern Ireland Electricity³¹⁹, estimated such transaction fees as equivalent to 0.2% on

³¹⁷ Connected HP NIEH Business Plan Section 10.1.2.

³¹⁸ Connected HP NIEH Business Plan, Chapter 10.

³¹⁹ Nera report p. 26.

the bond yield.

- 5.6.42 However, the Authority noted that this issue was addressed in the application directly³²⁰ where it was explained that these costs are not only for the issuance of the bond but also for putting in place the financial facilities to fund construction of the pipeline. The Authority considered that the explanation demonstrates that the figure includes additional costs compared to standard financing transaction fees, and regards the assumption as reasonable.

Gearing

- 5.6.43 Fourth, the application assumed that there would be 100% gearing, and that there was a coherent link between assumptions with regard to the need for and provision of a liquidity reserve, the impact this would have on the credit rating and the proposed yield.
- 5.6.44 The Authority noted that a structure with 100% debt is likely to be viewed as more risky for debt funders as there is no equity in place to provide a buffer to take on the risk of losses. The credit rating of such an entity is therefore likely to be lower than a similar company structured with some equity. It follows that a lower credit rating will lead to a higher cost of debt for a 100% debt financed company. Therefore without some action being taken it would not be appropriate for a 100% debt financed company to compare its cost of debt with comparator companies which are partly equity financed.
- 5.6.45 However, the Authority considered that the inclusion of a liquidity reserve by NIEH provides a buffer and would be likely to improve the credit rating and decrease the cost of debt.
- 5.6.46 In consequence, the Authority concluded that the assumption that it was appropriate to base the credit spread on companies in Annex 2 was a robust and internally consistent one. The inclusion of the liquidity reserve provided strong evidence that the gearing was based on robust assumptions.

Use of Cash Reserves

- 5.6.47 Fifth, the NIEH application assumed that existing cash reserves in Mutual

³²⁰ Connected HP NIEH Business Plan p.274 Evidence on Transaction Costs.

Energy's other gas companies would be used to offset certain upfront costs. This had the effect of reducing the transaction cost figure³²¹ included in the final financing costs by £2.76m (excl VAT).

5.6.48 However, the release of the cash reserves for this purpose could only take place with the Authority's agreement, as this is part of the regulatory structure within which NIEH operates.

5.6.49 The Authority therefore did not consider this to be a robust assumption as it is dependent on actions which are not within the control of NIEH and therefore very uncertain at the present time.

Final Conclusion

5.6.50 Considering as a whole the evidence provided to support the NIEH proposed WACC, NERA advised that it was based on robust assumptions³²².

5.6.51 The Authority generally agreed with and accepted this conclusion, and regarded the assumptions used by NIEH as being mostly robust and very well-evidenced. However, an exception should be made on the assumption relating to the use of cash reserves from other Mutual Energy companies, which could not be treated as robust for the reasons given above.

Evidence verifiable from previous experience

Weighted Average Cost of Capital

5.6.52 NIEH proposed to finance the G2W project entirely with debt funding³²³ and the application referenced the previous experience of NIEH in entering into such financing arrangements. This experience was referenced in comparing WACC rates from previous transactions³²⁴, and then considering transaction costs³²⁵ and liquidity costs.

5.6.53 NERA found the historical evidence to be reliable and drew particular attention to the inclusion of a liquidity reserve as demonstrating experience and knowledge

³²¹ Connected HP NIEH Business Plan p273

³²² NERA 2.2.5 p. 8 and 4.2.5 p. 18.

³²³ Connected HP NIEH Business Plan Section 10.1.

³²⁴ Connected HP NIEH Business Plan p.270

³²⁵ Connected HP NIEH Business Plan p274

in this area³²⁶. Therefore the Authority regarded this as a robust use of previous experience.

Capital Expenditure

5.6.54 In the case of Mobilisation, NIEH drew on past experience to derive its costs, but in the case of Design/Project Management there was little evidence provided that verifiable past experience had been applied.

5.6.55 The Authority concluded that the reliance on past experience was robust insofar as it was applied, but noted the limitations on its use by NIEH in relation to its capital expenditure data.

Identification and quantification of risk

5.6.56 The NIEH application recognised that between the time at which the application was made and the date any bond would be issued, conditions in the financial markets were likely to have changed and so there was a risk that the actual WACC presented in the application could be different. However, there was no discussion of the quantification of this risk.

5.6.57 The Authority considered that this risk was appropriately identified, but noted that no attempt was made to quantify it in terms of probability or impact.

5.6.58 Overall the Authority considered the identification and quantification of risk to be limited. The Authority would have expected the application to directly address the risks of each cost line with consideration given to the likelihood and impact of the risks and some discussion on possible mitigation measures in each case.

Efficiency improvement plan

5.6.59 NIEH indicated that the efficiency improvement plan provided³²⁷ constituted its submission in support of the Innovation and Technology Transfer sub-criteria. The Authority considered that the identification of innovation as the primary driver of efficiency improvement plan suggests an understanding of how such improvements are likely to be delivered.

5.6.60 There application also engaged in some discussion of how efficiency could be

³²⁶ Nera Section 4.2.5 p. 18

³²⁷ Connected HP NIEH Business Plan p240

improved through developing the market and working to introduce new suppliers as well as working with other companies to deliver economies of scale and avoid wasting materials. Again, the Authority considered these good examples which could result in efficiency improvements.

- 5.6.61 Overall, however, the Authority considered that, beyond referencing efficiencies that were already included in the costs, the efficiency improvements proposed had limited specific detail linked to the project costs and there no quantification was given of the examples that were presented.

Consideration of responses to the provisional decisions on 3.17(b)

- 5.6.62 As set out in chapter 2 BGE(UK) questioned whether the Weighted Average Cost of Capital submitted by NIEH, was consistent with the stated intention of the Authority as to the nature of the price control to be included in the licence of the preferred applicant.
- 5.6.63 The Authority previously indicated that the cost of capital to be reflected in the price control, in particular in the first control period, would '*equal as far as reasonable the costs revealed by the competitive process*'. BGE(UK) noted that, in its application, NIEH said that it would raise long-term bond finance only after the end of the construction process. BGE(UK) asked for clarity as to the consequences if, in the event of changes in the bond market between now and then, NIEH was unable to raise finance at the cost assumed in its application.
- 5.6.64 The Authority noted that this is not a question which bears directly on its provisional or final conclusions as to the preferred applicant and is instead a question which was about the conditions of the licence to be granted to the preferred applicant. This is explained more fully in chapter 2.
- 5.6.65 In their responses to the provisional decisions both Mutual Energy and SGN noted that the conditionality which was attached to NIEH's letters of comfort was only what would be expected of a project at this stage of development.
- 5.6.66 As set out in chapter 2 the Authority considered both of these submissions but noted that it merely reiterated what were clearly the Authority's own provisional

conclusions as to the letters of comfort³²⁸ and NIEH's evidence of its history of raising debt finance³²⁹ which had been given full credit in the provisional score against sub-criterion 3.17(b)³³⁰.

5.6.67 The Authority therefore did not consider that there was anything in this submission which required an amendment to its provisional conclusions or marks.

5.6.68 Mutual Energy's response also expressed surprise that NIEH's proposal to use case reserves from its other gas businesses to fund transaction costs should not be considered as robust. It stated that obtaining the required consent of the Authority to this use was a '*safe assumption*'.

5.6.69 As set out more fully in chapter 2 above the Authority disagreed with this statement. It was not valid, still less 'safe', of NIEH to assume the Authority's consent to a particular treatment of cash reserves would be forthcoming without having sought that consent or obtained any assurances as to it. The Authority remains satisfied with its provisional conclusion that the assumption was not 'robust'³³¹.

5.6.70 Mutual Energy's response also noted that one applicant (PNGL) was given a mark in relation to its Applicant Determined Costs against which others were benchmarked, even though that applicant then failed against the Resources Criteria. It stated that, while this did not affect the outcome, the NIEH application was nonetheless '*disadvantaged by losing 37.5 marks out of a possible 50 by being marked against a bid which was clearly without proper evidence*'. SGN's response made a similar point as set out in chapter 2 above.

In the application of the Criteria, the Authority does not have discretion as to the treatment of the Applicant Determined Costs³³². The Authority must apply this sub-criterion and marks are calculated mathematically in accordance with the rules set out in the Criteria. Therefore for the reasons set out more fully in chapter 2 above the Authority noted that this is not a question which bears

³²⁸ Chapter 5.6.32 to 5.6.34 of the Consultation.

³²⁹ Chapter 5.6.36 of the Consultation.

³³⁰ Chapter 5.6.63 to 5.6.65 of the Consultation.

³³¹ Chapter 5.6.50 of the Consultation.

³³² Chapter 2.8.8 to 2.8.11 of the Consultation.

directly on its provisional or final conclusions as to the preferred applicant.

Final mark for sub-criterion 3.17(b)

- 5.6.71 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the NIEH application should attract a medium score, and its final decision is to award 15 out of 20 marks, in relation to sub-criterion 3.17(b).
- 5.6.72 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.
- 5.6.73 By comparison with the other applications, the Authority considered that the NIEH application was clearly the strongest. The information and evidence that was presented in support of the WACC was the most clear, comprehensive and detailed of any applicant, providing the best and most well-supported analysis of how the WACC was built-up. Given the particular importance of the WACC, this part of the application was given appropriate weight, and taken by itself it would have attracted a very high mark. However, the derivation of capital expenditure data was less clear and detailed, and, while remaining better than that of any other applicant, not of the same standard as the WACC analysis. The overall mark reflected the impressive quality of the WACC analysis adjusted for the less clear and robust description relating to capital expenditure.

5.7. Specific Criteria – Operational Business Plan 3.17(c)

The experience of the applicant and others on whom it intends to rely in relation to network construction

- 5.7.1 As discussed above, NIEH indicated that it proposes to rely on a JV agreement with SGN through which it will be able to draw on SGN's skills and experience in the construction of high pressure pipelines in Great Britain.³³³

³³³ NIEH, OBP, p.18. JV partner staff are outlined in section 2, with the structural arrangements of the JV in section 2. Section 2.3 contains the CVs of the JV partner staff and contractors secured to provide a range of specialist services. The IT resources are referred to in section 4.5.

- 5.7.2 The OBP states that NIEH has arrangements in place with SGN to allow access to specialist staff³³⁴. It further states that construction resources will be sourced via the JV with SGN, and explains how this will be done in section 3.2.1.
- 5.7.3 The OBP provides information relating to SGN's experience in the construction of high pressure pipelines, of which it has built some 120km since 2005³³⁵. The qualifications and experience of named key personnel within SGN were also provided³³⁶.
- 5.7.4 The Authority considered that NIEH had provided clear evidence that staff with the skills and experience required to carry on the construction of the pipeline are already in place within SGN, which is an organisation with relevant experience of undertaking similar activities. In addition, it was satisfied that NIEH has shown that it can draw on SGN's experience of high pressure pipeline construction.
- 5.7.5 The Authority noted that NIEH provides details of relevant framework contracts which SGN currently has in place in relation to construction activities including design, land agent services, and supply of PE pipe and materials and steel pipe and fittings³³⁷. The Authority cannot directly assess the skills and experience of the bodies with which SGN has such arrangements. However, it considered that the internal experience upon which SGN can draw in relation to the construction of high pressure networks indicates that such arrangements, managed by experienced internal staff such as those named, are an appropriate means of supplementing that experience where necessary
- 5.7.6 Where roles within SGN need to be recruited an explanation was provided of appropriate arrangements for doing so.
- 5.7.7 Overall, the Authority considered that NIEH had demonstrated that it would have access to a significant degree of relevant experience, via its relationship with SGN, on which it will be able to draw in relation to managing the processes and resources necessary to construct a high pressure network

³³⁴ Ibid, section 2.4.

³³⁵ Ibid, p. 10.

³³⁶ Ibid, section 2.3.2.

³³⁷ Ibid, section 6.1.4.

The experience of the applicant and others on whom it intends to rely in relation to network operation

- 5.7.8 In its OBP, NIEH provided evidence of nine years' experience of operating high pressure gas pipelines in Northern Ireland³³⁸.
- 5.7.9 NIEH currently operates both the SNIP subsea pipeline and the BGTL³³⁹ pipeline. It stated that the operation of the new network would be an extension of its current activities, rather than a new activity requiring the creation of entirely new resources, and set out in its OBP the qualifications and experience of named key internal personnel³⁴⁰.
- 5.7.10 NIEH also stated that Mutual Energy staff are the only certified fully ownership unbundled transmission system operators in Northern Ireland and the Mutual Energy staff are the only system operator staff based in Northern Ireland³⁴¹.
- 5.7.11 NIEH indicated that in relation to the G2W network, as currently for its existing networks, it would contract with SGN for control room services, maintenance and emergency response³⁴². NIEH stated that as part of the JV agreement these services would be provided by SGN to the new company in a co-ordinated manner at commercial terms consistent with existing contracts once the new pipeline had been constructed³⁴³.
- 5.7.12 The OBP provided information to illustrate that NIEH has the IT systems necessary to operate the new high pressure network. Details were provided of the existing SCADA and telemetry systems supporting applications for grid control, and the OBP set out how it is intended these will be expanded to incorporate the new high pressure network³⁴⁴. NIEH stated that the new licensed area will leverage off these existing systems and any amendments or extensions needed to current systems were evidenced in detail³⁴⁵.
- 5.7.13 Overall, the Authority considered that NIEH had provided comprehensive and

³³⁸ Ibid, p.10.

³³⁹ Belfast Gas Transmission Ltd.

³⁴⁰ Ibid, section 2.3.2.

³⁴¹ Ibid, p. 10.

³⁴² Ibid, p.10

³⁴³ Ibid, p.18.

³⁴⁴ Ibid, p.176.

³⁴⁵ Ibid, section 5.5.3.

detailed information, with appropriate supporting evidence, to demonstrate that it has considerable experience in operating high pressure networks in Northern Ireland, and appropriate commercial arrangements which can be extended to the newly-licensed area.

5.7.14 This conclusion was supported by the advice received from Rune³⁴⁶.

Securing, mobilisation and management of resources

5.7.15 NIEH provided detailed proposals in relation to how it would seek to secure, mobilise and manage the internal and external resources necessary for the construction of the network.

5.7.16 As noted above, resources for construction would be sourced via its JV partner, SGN. In relation to internal resources the OBP indicated the staff that NIEH would make available for the construction of the network. However, NIEH stated that it does not envisage recruiting any additional long-term staff as the construction will primarily be undertaken by SGN.

5.7.17 The OBP stated that construction will be led by a named Construction Project Manager employed by SGN, reporting to an SGN First Report: Head of Major Projects. Key SGN management and construction personnel were also named and summary details of their experience provided³⁴⁷.

5.7.18 NIEH stated that the Construction Project Manager would be responsible for appointing sufficient resources to ensure that construction is delivered in accordance with requirements.

5.7.19 The OBP stated that the Construction Project Manager will lead the CPT, supported by appropriate Contract Management and Project Managers to enable the efficient and timely delivery of the new system. SGN will appoint up to five Project Supervisor/Officers (one per pipeline section) to support the Construction Project Manager and to manage the Major Works Contractors³⁴⁸.

5.7.20 In addition, NIEH provided information on the portfolio of specialist services

³⁴⁶ RUNE Associates, op cit, p.8.

³⁴⁷ Ibid. p. 48.

³⁴⁸ Ibid, section 2.1.2.

framework contracts held by SGN that can be used to supply the various skilled and experienced personnel to populate the required CPT. NIEH stated that this would provide options in letting this work either to a single contractor or a controlled number of contractors, with tangible benefits in management, known capability, competence and performance, availability/mobilisation of the appropriate resource, familiarity of the SGN requirements and a consistent approach³⁴⁹.

- 5.7.21 The OBP³⁵⁰ set out the roles which will be required for the construction of the pipeline, together with an indication of how such roles will be filled. In relation to those roles which require recruitment, annex 1 to the OBP sets out the role descriptions which SGN uses in such recruitment exercises.
- 5.7.22 As discussed above, NIEH stated that there will be no need to procure additional IT systems as all required systems exist and are operational. These can be extended to cover the new network once constructed³⁵¹.
- 5.7.23 Overall, the Authority considered that NIEH had provided and appropriately detailed information, with relevant supporting evidence, sufficient to demonstrate the appropriateness of its proposals to secure, mobilise and manage the internal and external resources necessary to construct the network.
- 5.7.24 This conclusion was supported by the advice received from Rune.³⁵²

Engagement with stakeholders

- 5.7.25 As noted above, the Authority considers there to be substantial overlap between sub-paragraphs 3.17(a)(i) and 3.19(g) of the Criteria. The Authority's analysis of NIEH's application under sub-paragraph 3.17(a)(i) is therefore of relevance and is adopted as part of its assessment here.
- 5.7.26 The OBP provided³⁵³ a comprehensive list of the stakeholders which NIEH has identified as relevant in the pre-construction and construction phases. With

³⁴⁹ Ibid.

³⁵⁰ Figure 2.4b

³⁵¹ Ibid, p. 97.

³⁵² Gas to the West Technical Advice on High Pressure Submissions, RUNE Associates, p.9 and p.11 and p.16.

³⁵³ Tables 3.6.1a and 3.6.1b

respect to each of these identified stakeholders, the tables outlined the high level messages and rationale for engagement and a high level description of the channels through which such engagement would take place. The table provided in section 7.2 of the OBP set out similar information in respect of the post-construction phase. The OBP also demonstrated a track record of stakeholder engagement with local communities³⁵⁴.

- 5.7.27 As noted in Chapter 2 of the provisional decision paper, sub-paragraph 3.19(g) contains a degree of specificity which is not contained in sub-paragraph 3.17(a)(i), as it refers to proposals in relation to particular groups of stakeholders which the latter does not. Those groups are identified as 'all relevant regulatory authorities and statutory agencies, other licence holders and private entities necessary to construct a high pressure network'.
- 5.7.28 The tables in the OBP described above were broken down by stakeholder group. In each case the tables began with a comprehensive list of statutory bodies.
- 5.7.29 Emphasis was placed on engagement with landowners. As explained above, the Authority considers landowners to be the key private stakeholder in regard to the construction of the high pressure network. NIEH demonstrated that it understands the particular importance of engagement with landowners, and has a plan for interactions with them.
- 5.7.30 The tables also outline proposed engagement with a range of private entities including business representative groups and forums, environmental groups, consumer groups, and other relevant operators.
- 5.7.31 Overall, the Authority considered that, NIEH had correctly identified many of the key stakeholders and had demonstrated that it has clear and appropriate plans for stakeholder engagement.

Timely delivery of the high pressure network

- 5.7.32 In its OBP, NIEH provided a detailed project plan based on SGN's previous experience in undertaking projects similar to G2W.

³⁵⁴ Ibid. p. 100

- 5.7.33 At fig 3.1.1a in the OBP a high level project plan diagram was included which indicates a period of approximately 3.75 years from award of licence to the completion of construction of the final section of the pipeline. The construction activities would span the final three year period within the overall programme. The OBP implied that completion of construction included commissioning the pipeline to deliver gas. The report from Rune states that the proposed timeline for completion is credible³⁵⁵.
- 5.7.34 The Authority considered that the management of risk is an important aspect of timely delivery of the network and NIEH provides a detailed assessment of initial high level construction risks³⁵⁶. The information for each risk identified comprises a risk description, programme impact, cost impact and mitigation. In addition some examples in Tables 4.1.3b, 4.1.3c and 4.1.3d of the OBP³⁵⁷ are provided of construction risk management on previous projects.
- 5.7.35 In its assessment of the matters arising under this heading the Authority also had regard to NIEH's proposal to substitute high pressure pipelines with low pressure pipelines in the section of the network to Strabane³⁵⁸. However, the advice from Rune states that NIEH had not presented information to suggest that a detailed review has been undertaken to identify alternative designs.³⁵⁹ The Authority accepted that advice and on that basis considered that it should give little weight to this proposal.
- 5.7.36 Overall, the Authority concluded that NIEH had a detailed project plan for the construction and commissioning of the pipeline over a period that was assessed to be credible and that took appropriate account of construction risks.

Measures to protect customers in the context of operating cost pass through

- 5.7.37 As noted above, the NIEH application was based on an operating cost pass through model. The Authority therefore considered what information NIEH had provided in relation to measures to protect customers in the context of operating

³⁵⁵ RUNE Associates, op cit, p.18.

³⁵⁶ NIEH, op cit, fig 3.1.1b, p. 69.

³⁵⁷ NIEH OBP, pp.136-137

³⁵⁸ Ibid, p 262.

³⁵⁹ RUNE Associates, op cit, p.16.

cost pass through. The Authority considered this to be an important matter to which it should give some weight, in accordance with the customer protection element of its duties under Article 14 of the Energy Order.

5.7.38 The OBP indicated that West Transmission Holdings Ltd. will be part of a group in which a mutual company is the ultimate parent. Consequently, there would be no possibility to distribute funds anywhere to a non-mutual company, since the entire group operated on a mutualised basis.

5.7.39 In addition, the OBP stated that each of the operational sub-groups within the Mutual Energy Group are also ring-fenced for financing and regulatory reasons so that no cross-subsidies exist.³⁶⁰

5.7.40 The Authority considered that these proposals were a reasonable vehicle for the protection of consumers, and noted that they reflected existing arrangements within the Mutual Energy Group which would effectively be extended rather than needing to be created for the purposes of the G2W project. Therefore there was no uncertainty relating to them. However, it noted that the arrangements were not comprehensively described and considered that greater detail could have been provided in relation to them.

5.7.41 Overall, the Authority considered that NIEH has provided appropriate proposals in respect of this issue.

Final mark for sub-criterion 3.17(c)

5.7.42 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the NIEH application should attract a medium score, and its final decision is to award 15 out of 20 marks, in relation to sub-criterion 3.17(c).

5.7.43 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.

5.7.44 By comparison with the other applications, as in relation to sub-criterion 3.17(a),

³⁶⁰ NIEH OBP, pp.17-18.

the Authority considered that the NIEH application provided strong evidence that it has accessible to it, from a combination of its internal resources and those sourced via its JV partner SGN, the required skills and experience relating to high pressure networks (both their operation and construction). This was clearly distinguishable from the PNGL application, but similar to that of BGE(UK); both applicants' mobilisation proposals were robust and their submissions indicated that the systems and contracts needed were largely in place or could be extended if required. Note was taken of NIEH's proposal to substitute some high pressure pipelines with low pressure pipelines, but this had not been subject to detailed design so little weight was given to it by comparison with PNGL's more developed proposal. In the round, NIEH's submission was judged broadly equivalent to that of BGE(UK) in respect of this sub-criterion.

5.8. Specific Criteria – Innovation & Technology

- 5.8.1 NIEH did not submit a separate document in relation to these sub-criteria and instead provided information in regard to innovation and technology transfer in specified sections of its OBP.
- 5.8.2 For the purposes of these sub-criteria, the Authority must have regard to the skills and experience of a person on whom an applicant proposes to rely. As noted above, NIEH is reliant for a range of matters on its JV partner SGN. The Authority considered that it was, within that context, similarly entitled to rely on SGN's experience of and proposals for innovation and technology transfer in relation to high pressure pipelines.

Environmental sustainability

- 5.8.3 NIEH did not directly address environmental sustainability in its OBP.
- 5.8.4 However, it did summarise a number of relevant innovations being used by SGN in Great Britain which the Authority considered to be relevant to environmental sustainability. One such example was the potential to use ground source heat pumps at pressure reduction stations to support traditional gas pre-heating

equipment and the use of micro-CHP (the Ecogen).³⁶¹

- 5.8.5 In addition, NIEH referred to SGN's involvement in the construction of the UK's first Biomethane to Grid plant at Didcot Sewage Works, Oxfordshire. It stated: 'The pioneering works included the clean up, quality monitoring and injection to trial biomethane injection into our network. Its success has shown that contributions can be made to the transition to a low carbon economy as the productions of biogas and biomethane are carbon neutral'.³⁶²

Efficiency in use of gas and new sources of gas

- 5.8.6 NIEH provided information in relation to efficiency in the use of gas, for example, the Immersion Tube Preheating Project³⁶³ which it stated would be assessed as part of the design phase for the new licensed area.
- 5.8.7 In relation to efficiency in the use of gas and the use of new sources of gas, NIEH described SGN's experience of biomethane in two separate projects (Didcot and Dorset) and indicated that to date SGN has processed over 360 enquiries for biomethane plants within the UK.³⁶⁴
- 5.8.8 The Authority therefore considered that NIEH had provided relevant information in regard to its ability to achieve innovation and technology transfer under this heading.

Cost efficiency

- 5.8.9 In its OBP³⁶⁵, NIEH clearly illustrated that cost efficiency (e.g. reduced operating cost and savings in fuel gas) is a focus of much of both its and SGN's innovation activities and states that cost efficiencies have resulted from many of the projects outlined.
- 5.8.10 The Authority considered that NIEH had provided some relevant information in relation to its ability to achieve innovation in relation to cost efficiency. However, the Authority noted that in the majority of examples NIEH did not quantify the

³⁶¹ Ibid, p.247.

³⁶² Ibid, p. 246.

³⁶³ Ibid, p.247-248.

³⁶⁴ Ibid, p.246.

³⁶⁵ section 8.4.2

savings obtained, and therefore considered that it could give only limited weight to the examples provided under this heading.

The development of the network to more remote geographical areas

- 5.8.11 NIEH described two specific proposals for the development of the high pressure network to more remote geographical areas, both of which were based on established technologies.
- 5.8.12 First, NIEH considered that the underlying challenge was to get gas to the areas without the use of an extensive transmission pipeline system and stated that the use of biomethane is one possible method to achieve this.
- 5.8.13 Second, NIEH stated that SGN has a long history of supplying gas to remote areas of Scotland and in particular uses a method whereby certain towns are supplied by a logistics system providing LNG by road tanker.³⁶⁶ NIEH stated that there is the potential to transfer this method to remote areas of Northern Ireland.
- 5.8.14 The Authority considered that there was clear evidence of NIEH having given careful thought to the issues arising under this heading in the context of the G2W project, and making proposals based on the previous experience of SGN in using technologies with the potential to be transferred to Northern Ireland.

History of innovation

- 5.8.15 In its OBP, NIEH pointed to a history of innovation on both its own part and that of SGN. This innovation related to both operations and engineering and includes pilot projects in telemetry and communications,³⁶⁷ new intervals methodology for in-line inspections³⁶⁸, and the use of turbo expanders³⁶⁹.
- 5.8.16 The Authority considers that NIEH has provided good evidence of a history of innovation on the part of both itself and SGN, some elements of which were directly relevant to the high pressure network.

³⁶⁶ Wick, Thurso, Oban and Cambeltown are supplied in this manner.

³⁶⁷ NIEH, op cit, p.245.

³⁶⁸ Ibid, p.248.

³⁶⁹ Ibid, p.249.

5.8.17 This conclusion was consistent with advice received from Rune.³⁷⁰

Ability to secure funding

5.8.18 NIEH stated that the majority of the SGN innovations which it described in its OBP were funded through Ofgem's Innovations Funding Incentives. In order to obtain funding under this scheme, SGN on an individual project basis would have to make submissions to Ofgem justifying the merits of its proposals.

5.8.19 The Authority therefore considered that NIEH has provided relevant information in regard to SGN's ability to secure funding from regulatory authorities in relation to innovation. This conclusion was supported by advice from Rune.³⁷¹

5.8.20 The Authority noted, however, that NIEH did not specify which of the projects it describes were funded by Ofgem, and its OBP was insufficiently clear and detailed in this respect.

Transfer of innovation into Northern Ireland

5.8.21 NIEH set out a number of proposals to transfer innovation from Great Britain into Northern Ireland. These examples include a new intervals methodology for online inspection, micro-CHP and thermo siphon approaches for gas pre-heating.³⁷²

5.8.22 The Authority considered that NIEH had made specific and relevant proposals outlining appropriate innovations on the part of both it and SGN that it proposes to utilise in the construction and operation of the high pressure pipeline and that would constitute the transfer of innovation into Northern Ireland.

5.8.23 This conclusion was supported by the advice from Rune.³⁷³

Existing skills and experience

5.8.24 NIEH did not specifically outline the existing skills and experience of either its or SGN's staff in relation to innovation.

³⁷⁰ RUNE Associates, *Gas to the West: Technical Advice on High Pressure Submissions*, 19 June 2014, p. 21.

³⁷¹ Ibid.

³⁷² See in particular *ibid*, section 8.4.2.

³⁷³ RUNE Associates, *op cit*, p. 21.

- 5.8.25 However, the Authority recognised that there is some overlap between this sub-paragraph and sub-paragraph 3.21(b)(i), as evidence of a history of innovation is one way in which skills and experience may be demonstrated.
- 5.8.26 Moreover, the Authority also noted that SGN is subject to Ofgem's RIIO³⁷⁴ regulatory approach which specifically incentivises innovation. The NIEH OBP states that the RIIO approach to regulation is now embedded in SGN's business and that, through its the JV arrangements with SGN, NIEH expects the benefits from the RIIO initiatives and improvement plans to benefit customers of the high pressure network to which the licence relates.³⁷⁵
- 5.8.27 The Authority therefore considered that some credit could be given to NIEH for the skills and experience that are clearly available to it in the context of the G2W project, though these could have been more directly explained for the purposes of this heading.

Consideration of responses to the provisional decisions on 3.17(c)

- 5.8.28 Mutual Energy's response contended that '*little weight*' should be given to any proposals at this stage to replace high pressure with low pressure pipelines. It also stated that while the NIEH application aimed at a three year construction timeline, this did not seem to attract any benefit when measured against applications which indicated that four years was a more feasible timetable.
- 5.8.29 As set out more fully in chapter 2 above the Authority noted that it had explicitly given 'little weight' to NIEH's own proposal to substitute high pressure with low pressure pipelines, having regard to the advice from Rune, which Mutual Energy does not challenge, that the quality of the proposal was poor³⁷⁶.
- 5.8.30 Revisiting these provisional assessments in the light of Mutual Energy's response, the Authority was satisfied that they were correct and in any case the substitution proposals were not a major factor in the overall scoring of sub-criterion 3.17(c).

³⁷⁴ RIIO stands for 'Revenue = Incentives+ Innovation + Outputs'.

³⁷⁵ NIEH, op cit, p.242.

³⁷⁶ Chapter 5.7.35 of the Consultation.

- 5.8.31 With regard to the question of timing, the Authority noted that in relation to the other applicants it had accepted the advice of Rune.
- 5.8.32 While BGE(UK) suggested the possibility of a four year timetable, it had produced a credible timeline for a three year construction period,³⁷⁷ as had NIEH³⁷⁸. The Authority did not consider that it would be appropriate for BGE(UK) to be given a lesser mark against the sub-criterion because it had questioned the specified timetable, particularly in circumstances in which it had also produced a credible plan to meet it. The Authority was satisfied that it had made appropriate judgments in relation to these matters in reaching its provisional conclusions and marks, and that it was not appropriate to adjust them.

Final Conclusion

- 5.8.33 The Authority considered that NIEH had, working with its JV partner SGN, been able to demonstrate a good track record in innovation, and made specific and thoughtful proposals relating to the G2W project which had the potential either to achieve innovation as part of that project in Northern Ireland or the transfer of technology to Northern Ireland in respect of the high pressure network.

Final score for the ITT sub-criteria

- 5.8.34 Having regard to the application and in particular to the matters identified above, the Authority confirms that the NIEH application should attract a medium score, and its final decision is to award 15 out of 20 marks, in relation to the ITT sub-criteria, to be allocated equally between sub-criteria 3.21(a) and (b).
- 5.8.35 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them
- 5.8.36 When compared to the other applications, the Authority considered that the NIEH application provided good evidence of its ability to achieve innovation and technology transfer in the context of the G2W project. NIEH had submitted the

³⁷⁷ Chapter 3.7.36 of the Consultation.

³⁷⁸ Chapter 5.7.34 of the Consultation

clearest and most detailed application in this regard, demonstrating a stronger history of innovation and more carefully considered proposals to innovate or to transfer technology into Northern Ireland than any other applicant.

5.9. Resources Criteria

- 5.9.1 Having carried out a detailed analysis of the NIEH application, and in particular considered the OBP for the purpose of awarding marks under sub-criteria 3.17(a) to (c), the Authority then considered whether NIEH meets each of the Resources Criteria.
- 5.9.2 As described in Chapter 2 of the provisional decisions, and for the reasons set out there, this entailed taking the Resources Criteria out of the formal sequence in which they appear in the Criteria, and considering them as a final check on the application as a whole; following, and drawing on the detail, of the analysis of the OBP.
- 5.9.3 On this basis, for the purposes of these two criteria, the Authority carried out an overall assessment of the information and evidence that was revealed by the NIEH application in relation to the adequacy of its resources.
- 5.9.4 More specifically, the Authority:
- a. considered carefully whether NIEH has demonstrated that it has, or is making appropriate arrangements to obtain, the resources required to meet the obligations to be included in the conditions of the high pressure licence (the Adequate Resources Criterion); and
 - b. considered in particular whether NIEH has demonstrated that it has the resources and financial standing to undertake the activities to be carried out for the purposes of meeting those obligations (the Financial Resources and Standing Criterion).
- 5.9.5 For these purposes, the Authority had particular regard to whether NIEH has demonstrated that it will have the financial resources for the construction of the high pressure network while being subject to a revenue restriction that reflects the financial terms of its application. This will constitute the most substantial

obligation of any applicant which is successful in obtaining the licence.

Final assessment following sub-criteria 3.17(a) to (c)

- 5.9.6 In carrying out this assessment, the Authority began with the marks awarded by it in relation to sub-criteria 3.17(a) to (c).
- 5.9.7 As indicated above, NIEH was awarded a 'high' score in respect of sub-criterion 3.17(a), and 'medium' scores (in each case at the top end of that range) in respect of sub-criteria 3.17(b) and (c).
- 5.9.8 As explained in Chapter 2 of the provisional decisions, where an applicant is awarded marks which fall within the medium to high parts of the range, it might be expected that its application would reveal a broad adequacy of resources for the purposes of the licence.
- 5.9.9 Sub-criteria 3.17(a) and (c) are essentially concerned with the assessment of the application in relation to what the Adequate Resources Criterion describes as 'systems and apparatus' and 'human and other resources'. Sub-criterion 3.17(b) is essentially concerned with the assessment of the application in relation to what the Adequate Resources Criterion describes as 'financial resources and facilities'.
- 5.9.10 In respect of these three sub-criteria, NIEH was awarded, once the marks were given their appropriate weighting for the purpose of the Best Value Criterion, 78% of the available marks.
- 5.9.11 This is consistent with what was anticipated in Chapter 2 of the provisional decisions, and what was in fact found by the Authority on its assessment of the relevant parts of the OBP, which is that these scores reflect the final conclusions by the Authority which reveal a broad adequacy of the relevant resources on the part of NIEH.
- 5.9.12 The Authority's assessment of the quality of information and evidence submitted in the relevant parts of the OBP is set out above, and need not be repeated here in full.
- 5.9.13 In summary, what the Authority identified was that NIEH is experienced in the operation of high pressure networks in Northern Ireland, has a JV with SGN that

allows it to have access to the skills of a company which is experienced in the construction of high pressure networks, and has a track record of raising 100% debt finance in respect of high pressure networks and a clear and detailed plan to do so at a cost of debt which it has justified as reasonably achievable.

- 5.9.14 The Authority therefore considered that NIEH had produced clear and detailed evidence that it either has, or is making appropriate arrangements to acquire, the systems, apparatus, human and other resources, and financial resources and facilities required for the purposes of the G2W high pressure licence.

Final Conclusion

- 5.9.15 On the basis of the information and evidence provided to it in the NIEH application, the Authority had no reason to question that NIEH will have either the financial or non-financial resources that it requires for the purposes of the high pressure licence. Those matters are well-evidenced.

- 5.9.16 Therefore, the Authority concludes that NIEH:

- a. has demonstrated to its satisfaction that it either currently has, or is making appropriate arrangements to ensure that it would have in place by the time it would commence regulated activities under the high pressure licence (if granted), the financial and other resources likely to be sufficient for the purposes of meeting its obligations under the conditions of that licence; and
- b. has demonstrated that it has the resources and financial standing to undertake the activities to be carried out for the purposes of meeting those licence obligations.

- 5.9.17 In consequence the Authority's final conclusion is that NIEH meets both of the Resources Criteria.

6.0 PNGL High Pressure Connected

6.1. Introduction

6.1.1 This chapter:

- a. considers the application made by Phoenix Natural Gas Ltd (**PNGL**) for the high pressure licence, which is connected to its own application for the low pressure licence;
- b. the responses received to the consultation on the provisional decisions, as these relate to the connected application made by PNGL;
- c. sets out the Authority's final conclusions as to whether PNGL has met each of the criteria other than the Best Value Criterion;
- d. sets out the Authority's final assessment of the marks to be awarded to PNGL in respect of the different elements of the Best Value Criterion;
- e. explains the reasons of the Authority for its final conclusions and marks.

6.1.2 In this chapter, the criteria have been addressed in the order in which they are set out in Chapter 2 of the provisional decisions, and the Authority has followed the approach to interpreting and applying the criteria that is set out in that chapter.

6.2. The Information Criterion

6.2.1 Both an electronic and a printed copy of the PNGL application were received by the Authority before the deadline of noon on 6 May 2014.

6.2.2 Once the deadline had passed the application was opened and checked for completeness against a pre-prepared checklist. The application was assessed as being complete except in two respects:

- a. it was not clear from the application what information was being relied on by PNGL for the purposes of meeting the Adequate Resources Criterion; and

- b. there was no clear statement of whether the application was being made for a 'cost pass through' or 'revenue cap' high pressure licence³⁷⁹.
- 6.2.3 PNGL was informed of these apparent omissions and was given until noon on 14 May 2014 to provide the missing information. A response was received by the deadline and it was subsequently judged that this addressed the omission in full³⁸⁰.
- 6.2.4 Having considered these facts, the Authority concluded that PNGL has provided all the information requested by the Authority, in such manner and by such times as was specified, and therefore meets the Information Criterion.

6.3. The Constitution Criterion

- 6.3.1 PNGL is a limited company with its registered office in Northern Ireland. PNGL's constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations³⁸¹.
- 6.3.2 Having considered this evidence, the Authority was satisfied that PNGL has demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.
- 6.3.3 The Authority therefore concluded that PNGL meets the Constitution Criterion.

6.4. The Fit and Proper Person Criterion

- 6.4.1 Evidence to demonstrate that PNGL is a fit and proper person was provided to the Authority in accordance with paragraphs 20 to 26 of Schedule 2 to the Application Regulations³⁸². It consisted of a signed statement by a senior officer of PNGL to the effect that PNGL had no information to disclose under any of those paragraphs.

³⁷⁹ Applicant Information Pack paragraph 4.41.

³⁸⁰ Email response received 12 May 2014.

³⁸¹ HP Connected Schedule 2 part 1.

³⁸² HP Connected Schedule 2 part 1.

- 6.4.2 The Authority considered this evidence and noted that the information provided in respect of the criterion did not mention a threatened enforcement action by the Authority in relation to PNGL's existing gas conveyance licence. The Authority would have expected this to have been mentioned, and PNGL's failure to do so did not satisfy the requirements of the Application Regulations³⁸³.
- 6.4.3 However, no conclusions have been reached by the Authority in relation to that threatened action, and the Authority did not in any event consider that the matter was sufficiently serious to call into question whether PNGL was a fit and proper person to be granted the licence. The Authority noted that PNGL has no other record of enforcement action being taken against it, or any other adverse factor of the type listed in the Application Regulations.
- 6.4.4 On the basis of the evidence provided to it, the Authority was therefore satisfied that PNGL meets the Fit and Proper Person Criterion.

6.5. Specific Criteria – Operational Business Plan 3.17(a)

Engagement with stakeholders

- 6.5.1 PNGL provided a list of stakeholder organisations with which it currently engages, together with a high level description of its current engagement activities which include an annual programme of ongoing engagement. It also briefly described the channels through which it communicates with stakeholders and cites social media and YouTube in this regard alongside direct meetings³⁸⁴.
- 6.5.2 In relation to the G2W project, PNGL stated that as part of any design and construction work it will engage with a range of external stakeholders from statutory bodies to local interest groups and potential customers³⁸⁵. It provided a list of ten specific stakeholders with which it will engage³⁸⁶, three of which it went on to discuss at a high level: namely the Roads Service, Local Councils and

³⁸³ It did not, however, constitute a failure to meet the Information Criterion, since the relevant information had not been requested by the Authority.

³⁸⁴ PNGL, *High Pressure Operational Business Plan*, pp. 210 – 11.

³⁸⁵ *Ibid*, p. 59.

³⁸⁶ *Ibid*.

'other utilities'³⁸⁷.

- 6.5.3 PNGL stated that it will appoint land agents who will visit each landowner/tenant to explain the project in general terms and the consenting process³⁸⁸. It also stated that an Agricultural Liaison Officer will liaise with farmers and landowners on a daily basis to listen to and rectify any concerns they may have, in particular where they believe construction activities may be interfering with farming activities³⁸⁹.
- 6.5.4 The Authority considered that PNGL's description of how it will engage with key stakeholders was not comprehensive and lacked important content. Its proposal provided specific discussion of engagement with only three stakeholders, the selection of which placed a particular emphasis on public affairs (PNGL referred, for example, to the need for early dialogue with local councils³⁹⁰) in apparent preference to other relevant considerations.
- 6.5.5 Although it was clear that PNGL understands the political context of the G2W project, the Authority considered that its approach to stakeholder engagement did not reflect a full appreciation of other relevant contexts.. PNGL proposals for dealing with landowners indicated that the role of the PMC will be important – the PMC will appoint land agents³⁹¹ and will prepare wayleave plans³⁹².

Skills and experience of key members of staff and any other persons

- 6.5.6 PNGL stated that it was responsible for constructing, operating and maintaining the Belfast Gas Transmission network for a period of around 12 years from 1996 until it was sold in 2008. It stated that although it has not been directly involved in gas transmission activities over the last few years, key personnel who were previously responsible for transmission are still employed by the company³⁹³. However, those members of staff were not named, nor were any curricula vitae provided listing their skills and experience.

³⁸⁷ Ibid, pp. 59 – 61.

³⁸⁸ Ibid, p.71.

³⁸⁹ Ibid, p.81.

³⁹⁰ Ibid, p.60.

³⁹¹ Ibid, p. 71

³⁹² Ibid, p. 72.

³⁹³ Ibid, pp. 11 – 12.

- 6.5.7 PNGL provided a table listing, at a general level, the professional qualifications and experience relating to various roles within the organisation³⁹⁴. However, it was not clear that the skills and experience identified in respect of those roles is applicable to high pressure pipelines.
- 6.5.8 The Authority considered that the evidence provided by PNGL of the skills and experience of its current staff in relation to the construction and operation of high pressure pipelines was extremely limited.
- 6.5.9 PNGL stated that it has engaged external advisors, Penspen Limited and RPS Ireland Limited, to assist in the development of a high level programme.
- 6.5.10 PNGL proposed that critical activities in the mobilisation phase of high pressure pipeline construction will be carried out by a competent external Project Management Contractor (PMC). The PMC will be responsible for³⁹⁵:
- a. project management;
 - b. pipeline route verification;
 - c. planning and consultation;
 - d. environmental impact assessment;
 - e. easements, consents and land acquisition;
 - f. front end engineering design;
 - g. development of invitations to tender;
 - h. project management during construction; and
 - i. commissioning.
- 6.5.11 The Authority noted that PNGL's OBP was unclear as to when the PMC will be appointed, referring at some points to beginning the procurement process for the appointment upon award of the licence³⁹⁶ and at others to beginning the process

³⁹⁴ Ibid, pp. 28 – 30.

³⁹⁵ Ibid, p. 58.

³⁹⁶ Ibid, pp. 20 and 36.

as soon as the preferred applicant is announced by the Authority³⁹⁷.

- 6.5.12 PNGL also stated that a specialist pipeline construction contractor will be appointed to carry out the actual construction, as will a Construction, Design and Management Coordinator³⁹⁸.
- 6.5.13 Overall, the Authority considered that PNGL has limited recent experience of the construction and operation of high pressure pipeline systems, and the evidence of its capability was substantially based on organisational arrangements, policies and procedures associated with its current low pressure network licence. In order to undertake the activities that will be the subject of obligations under the licence, it was clear that PNGL will be primarily dependent on external resources and the recruitment of a number of significant roles such as the PMC.
- 6.5.14 In its assessment under this heading, the Authority would have expected to be provided with evidence of the skills and expertise of persons already appointed or proposed to be appointed to the relevant roles. However, as such persons have not been recruited, PNGL was unable to provide details of the skills and experience of the persons who will undertake these key roles. The Authority was therefore unable to undertake any assessment of the skills and experience of those persons on whom PNGL will be required to rely.
- 6.5.15 Although PNGL referred to 'a PMC, such as Penspen' when describing activities in relation to the construction of the pipeline³⁹⁹, this was insufficient for the purposes of the Authority's consideration under this heading. It is not for the Authority to speculate whether Penspen will in fact be appointed to that role and, if it is, what the relevant skills and experience of its key individuals might be.
- 6.5.16 Similarly, although PNGL set out its tendering arrangements (discussed below), this did not aid the Authority's consideration under sub-paragraphs 3.17(a)(ii) and (iii) of the Criteria, since what was required to be assessed were the skills and experience of identifiable personnel to whom PNGL will have access, not its high level ability to appoint appropriate contractors.

³⁹⁷ Ibid. pp. 41 and 74.

³⁹⁸ Ibid. p. 35.

³⁹⁹ Ibid, p. 62. See also similar comments at pp. 234, 236, 237 and 238.

Management of risk

- 6.5.17 In section 4.1 of its OBP, PNGL provided: (i) an identification and quantification of risk issues, including significant asset risk issues; (ii) a description of the policy and processes to identify and manage risk issues; and (iii) a description of the procedures to mitigate risk and monitor actions to completion.
- 6.5.18 PNGL then proceeded to provide detailed information on its Corporate and Operational Risk Registers, risk assessment processes, the work of its Risk Review Committee and Network Safety Group and the role of audit in providing the Directors with assurance that risks identified are being appropriately managed⁴⁰⁰.
- 6.5.19 PNGL stated that it envisaged that its current processes with regard to risk identification and management will be applied to its activities under the high pressure licence⁴⁰¹.
- 6.5.20 PNGL indicated that 'significant work has already been undertaken to fully understand the risks associated with the construction of the transmission pipeline and a detailed preliminary plan to deliver gas as soon as possible while minimising costs has also been produced'⁴⁰².
- 6.5.21 There was some evidence in the OBP that PNGL had identified specific risks in relation to the G2W project. For example, it proposed the appointment of the PMC at an early stage to 'minimise the mobilisation phase and therefore mitigate the risk of delays to the commissioning of the GTW HP Pipeline System'⁴⁰³. It also highlighted risk arising from the public's association of natural gas with shale gas and the importance of ensuring, by emphasising the differences between the two, that opposition to the latter does not transfer to the former⁴⁰⁴.
- 6.5.22 The Authority considered that PNGL had demonstrated that it has a robust policy for the identification and management of risks, and in addition that there was some evidence that this approach had been applied to identify a limited number

⁴⁰⁰ Ibid. pp. 99 – 105.

⁴⁰¹ Ibid, p. 112.

⁴⁰² Ibid. p. 15.

⁴⁰³ Ibid. p. 41.

⁴⁰⁴ Ibid, p. 202.

of specific risks relating to the G2W project and provide for their mitigation.

6.5.23 This view was supported by the report from Rune⁴⁰⁵.

6.5.24 However, the Authority noted that no evidence was presented of any relevant experience on the part of PNGL regarding the identification and management of risk in relation to the construction of a high pressure pipeline.

Tendering arrangements

6.5.25 At section 6.1 of its OBP, PNGL set out high level details of the policies and procedures which it uses to ensure compliance with the requirements of EU procurement law. It also specified financial thresholds for advertisement in the EU Journal.

6.5.26 The OBP also set out at a high level how procurement within PNGL is currently managed, and demonstrated an appreciation and understanding of best practice tendering⁴⁰⁶. PNGL stated that its current procurement processes would be applied to the G2W project⁴⁰⁷.

6.5.27 However, the report which the Authority received from Rune noted that there was no clear evidence in the application of consideration of a strategy to address the specific procurement requirements of the G2W project⁴⁰⁸.

6.5.28 The Authority considered this evidence and concluded that, although PNGL had provided a high level description of its current tendering arrangements and stated that it would use these in relation to the G2W project, the OBP lacked detail on how the use of existing arrangements will be tailored to the project.

6.5.29 The Authority also noted that PNGL does not have experience of tendering for the construction of a high pressure pipeline and that there is limited evidence that it has in place appropriate framework contracts in place which it could utilise.

6.5.30 The Authority also noted that procurement of some of the required materials will be the responsibility of the construction contractor which, as noted above, has

⁴⁰⁵ RUNE Associates, op cit, pp.2 – 3.

⁴⁰⁶ PNGL, op cit, p.192 – 199.

⁴⁰⁷ Ibid, p. 191.

⁴⁰⁸ RUNE Associates, op cit, p. 5.

not yet been identified. The Authority was therefore unable to assess either the experience of the construction contractor in undertaking such procurement or the systems and processes which it might have in place to do so.

- 6.5.31 Overall, the Authority considered that PNG's OBP was weak in respect of the matters considered under this heading. This view was supported by the report from Rune⁴⁰⁹.

Final mark for sub-criterion 3.17(a)

- 6.5.32 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the PNG application should attract a low score, and its final decision is to award 6 out of 20 marks, in relation to sub-criterion 3.17(a).
- 6.5.33 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.
- 6.5.34 By comparison with the other applications, the Authority considered the PNG application to have provided very limited detail of how it would carry out activities under the licence, reflective of a lack of evidence as to its skills and experience in relation to high pressure networks (both their operation and construction). PNG was uniquely reliant on an external PMC who has not been appointed and could not be identified or assessed as to skills and experience. Its stakeholder plan in relation to landowners was limited in scope and effect. Other applicants had greater expertise and experience in relation to high pressure networks.

6.6. Specific Criteria – Operational Business Plan 3.17(b)

- 6.6.1 Table 6.6.4 below sets out values for each of the cost items submitted by PNG in its application⁴¹⁰.
- 6.6.2 These figures cover all the relevant data that were provided by PNG and the

⁴⁰⁹ Ibid.

⁴¹⁰ HPDIW Phoenix High Pressure Data Input Workbook.

Authority therefore carried out its assessment for the purposes of sub-criterion 3.17(b) against PNGL's description of its derivation of those data.

- 6.6.3 The Authority divided the costs into two broad categories of WACC and Capital Expenditure. The Capital Expenditure category consisted of four separate cost lines: Design/Project Management, Contingency, Mobilisation and Other Applicant Costs. These cost lines are consistent with what the Authority stated applicants should supply in the Data Input Workbook⁴¹¹. It should be noted that the WACC figures provided by PNGL were stated⁴¹² to be based on a cost pass through model and therefore subject to adjustment on the basis described in section 1.4.14 above.

Table 6.1: PNGL High Pressure Data Input Workbook Cost Items

Cost Item	Value
Weighted Average Cost of Capital	Yr 1 & 2 = 3.41% Yr 3 - 40 = 1.00%
Design / Project Management	£5.000m
Contingency	£4.100m
Mobilisation	£0.618m
Other Applicant Costs	£3.727m

Description of the derivation of cost data

Weighted Average Cost of Capital

- 6.6.4 NERA was requested to produce a report on what it would expect to see in a well-evidenced WACC submission. The Authority substantially agreed with the assessment reflected in that report. It follows the Authority would have expected to see:

⁴¹¹ To assist the applicants, the Authority also provided some detail on each cost area in the Application Information Pack.

⁴¹² Email 2014-05-12 PNGL replied to information request.

- a. The cost of debt set out using: (i) a benchmark gilt yield (to reflect a risk free rate) plus evidence on corporate debt spreads with market evidence provided for both; and/or (ii) direct evidence of corporate debt yields with market evidence provided. For this purpose, references to corporate debt spreads/yields should reflect companies with similar risk profiles, issuance costs should be included in the cost of debt and the treatment of inflation should be clearly explained in the derivation.
 - b. The cost of equity set out using CAPM and incorporating the risk free rate, equity risk premium and beta with relevant evidence provided to justify each component.
 - c. The proposed gearing including a discussion on how this interacts with the risks of the project, the proposed credit rating and the cost of debt.
- 6.6.5 PNGL in its application identified two separate periods between which the WACC would differ. The interim period was for years one and two, was based on a debt/equity capital structure with a WACC of 3.41%, and was presented in a table⁴¹³. The second period was to run from year three onwards, and PNGL proposed a 'mutual' WACC of 1% in relation to this period which would be 100% debt financed.
- 6.6.6 These figures reflected PNGL's proposal to use a debt/equity model to construct the pipeline in the interim period, during which it would be owned by PNGL, and then to either sell the company to Mutual Energy Limited (MEL) or to establish a new company limited by guarantee to sit outside the Phoenix Group structure.
- 6.6.7 The Authority considered that the application was an incomplete description of the derivation of the WACC and contained very limited evidence in support of the figures proposed.
- 6.6.8 In respect of the interim period, a cost of debt, cost of equity and gearing figure were set out in a table to build up the 3.41% WACC. It was explained that the cost of debt was based on project finance arrangements carried over from the construction period and that the equity figure had been 'benchmarked against

⁴¹³ HPOBP Phoenix High Pressure Operational Business Plan p.244.

transmission returns determined elsewhere⁴¹⁴.

- 6.6.9 In respect of the mutual period, the WACC was 100% debt and was based on the estimated yield from a long dated index linked bond⁴¹⁵. The 1% figure was stated to reflect what could be achieved based on current market conditions⁴¹⁶.
- 6.6.10 The Authority considered that in respect of both the interim and mutual period the description of how the WACC figures were derived was minimal. In addition, very limited evidence was presented in support of the assertions made about the likely value of the components contributing to the WACC figures. For example, no evidence was provided to explain the risk free rate or corporate debt spreads, and there was no inclusion at all of the equity risk premium or beta.
- 6.6.11 Overall the description of how the relevant data were derived fell considerably short of what the Authority would have expected to see in a well-evidenced submission.
- 6.6.12 NERA found that, based on the limited detail provided, it was unable to conclude that the PNGL application was based on reliable evidence and that therefore, it could not be considered well-evidenced⁴¹⁷. NERA also noted the lack of detailed evidence related to credit rating and credit risk in support of the proposed capital structure, and again concluded that this part of the application could not be considered as being well-evidenced⁴¹⁸.

Capital Expenditure

- 6.6.13 PNGL provided an explanation of some of its cost items but not others. There was no spreadsheet provided to allow detailed analysis of the figures.
- 6.6.14 In the case of Mobilisation, the Authority considered that the build-up of costs⁴¹⁹ was described in a reasonable way, though there was a lack of detail as to the costs associated with various activities, e.g. public relations. However, since this cost line is significantly lower than the other three costs lines, the Authority was minded to accord correspondingly limited weight to these figures.

⁴¹⁴ HPOBP Phoenix High Pressure Operational Business Plan p.243.

⁴¹⁵ HPOBP Phoenix High Pressure Operational Business Plan – Chapter 10.

⁴¹⁶ HPOBP Phoenix High Pressure Operational Business Plan p.244.

⁴¹⁷ NERA 2.2.7 p. 7 & 3.2.3 p. 13.

⁴¹⁸ NERA 4.2.3 p. 17.

⁴¹⁹ HPOBP Phoenix High Pressure Operational Business Plan – Chapters 1 – 9 Section 3.3.

- 6.6.15 In the case of Design/Project Management, there was no explicit explanation of the proposed £5m cost. There was some detail on the numbers of staff needed for onsite project management work⁴²⁰, but overall the Authority found that it was not possible to understand how this cost was derived.
- 6.6.16 In the case of Contingency, no information explaining the derivation of this cost item was provided, and the Authority therefore considered that the description of the data was incomplete and incapable of detailed analysis.
- 6.6.17 In the case of Other Costs, it was explained that this cost line relates to project financing during the construction period⁴²¹. The figure was stated to be based on discussions with several banks, but no evidence was provided in support of that proposition. No spreadsheet was provided to explain any of the calculations. The Authority would expect at least to have been provided with an explanation of what rates were used to calculate the final figure. Overall, the information given to explain this cost line was weak.

Identification and application of cost drivers

- 6.6.18 The Authority considered that PNGL had provided some reasonable information on mobilisation cost drivers⁴²² including a good discussion on manpower costs. However, there was limited detail in the numerical build-up of each cost line to explain final figures, e.g. there was no breakdown of IT costs.
- 6.6.19 While some cost drivers were provided for Design/Project Management costs⁴²³, these covered only the number of staff required for onsite project management work. No other cost areas were included (e.g. design) and no explanation as to how the final figure was arrived at was provided.
- 6.6.20 For Other Costs, no figures were provided and there was no calculation evident to explain the cost line.

Robustness of assumptions

- 6.6.21 The Authority identified and considered a number of assumptions that appeared

⁴²⁰ HPOBP Phoenix High Pressure Operational Business Plan – Chapters 1 – 9 p. 238.

⁴²¹ HPOBP Phoenix High Pressure Operational Business Plan p.242.

⁴²² HPOBP Phoenix High Pressure Operational Business Plan – Chapters 1 – 9 Section 3.3.

⁴²³ HPOBP Phoenix High Pressure Operational Business Plan – Chapters 1 – 9 p. 238.

to have been made by PNGL when deriving the data contained in its Data Input Workbook. All of these relate to the WACC.

The Value of the WACC

- 6.6.22 First, the Authority took it to be implicit throughout the application that PNGL had assumed it will be able to carry on the licensed activities under the high pressure licence, and to do so consistently with its obligations under that licence, on the basis of the proposed WACC. That is to say, there was an implicit assumption that PNGL will be able to raise the finance required to construct and operate the high pressure network while subject to a revenue control condition embodying its proposed WACC.
- 6.6.23 For the purpose of testing this assumption, the Authority considered whether the proposed WACC fell within the range of what might reasonably be expected in the context of the G2W project. To do this, it considered the market cost of debt and equity based on advice received from NERA, which took into account in its report such costs as referenced in recent regulatory decisions⁴²⁴. NERA advised on what it considered to be the 'plausible range' within which it would expect any WACC for this project to lie. The Authority relied upon the advice contained in the report as establishing a range against which to test PNGL's assumption.
- 6.6.24 NERA established a 'plausible range' in respect of a 100% debt-financed model of 1.07% - 2.9%⁴²⁵, and PNGL's proposed WACC after the initial 'interim period' was 1%.
- 6.6.25 The Authority took into account the lower bound for the cost of debt identified by NERA of 1.07%⁴²⁶, but considered that this figure was too low given that liquidity reserves and transaction costs would need to be added. The Authority had regard to its own experience of previous 100% debt financed entities where similar liquidity reserves and transaction costs were needed. It noted that neither cost was included in the PNGL proposed WACC (see further below).
- 6.6.26 In any event, even before adding these costs, the Authority noted that the PNGL proposed WACC for the mutual period was below the NERA figure of 1.07% at

⁴²⁴ NERA, Gas to the West, A report for the Utility Regulator.

⁴²⁵ NERA p.33.

⁴²⁶ NERA, Gas to the West, A report for the Utility Regulator p.33.

the bottom of its plausible range.

- 6.6.27 In support of its ability to finance the project, PNGL provided a number of letters of comfort from financial institutions.
- 6.6.28 It indicated that it would seek to finance the construction and operation of the high pressure network during the interim period prior to mutualisation through a mix of equity and debt funding. In relation to the former it provided a letter from the RBS Group Pension Fund which stated that it was prepared to commit equity equal to £30m. For the remainder of the period prior to mutualisation and the period following mutualisation funding would be by way of debt finance, and PNGL provided comfort letters from a number of banks in relation to this⁴²⁷.
- 6.6.29 The Authority considered that these letters did not represent a firm commitment by the relevant banks to provide the required financing. The letters note that any future funding commitment would be conditional on several factors, including credit market conditions, satisfactory due diligence, the final form of the legal documents and the licence, and other factors. They are not legally binding, nor do they purport to be so. Moreover, the Authority did not understand them to commit the banks in any sense that might properly be regarded (even allowing that they fall short of a legal obligation) as entailing a 'firm' commitment.
- 6.6.30 In order to clarify whether its understanding of the status and effect of the comfort letters was correct, the Authority sought advice from both NERA⁴²⁸ and the Strategic Investment Board⁴²⁹. Each of them confirmed the Authority's initial view that there was significant conditionality attached to the letters, including in relation to due diligence and internal bank clearances. The Strategic Investment Board noted that while the letters 'certainly indicate willingness from the funders concerned to participate in the project', it did 'not believe that the letters can be relied upon as evidence'. The Authority accepted this advice.
- 6.6.31 This did not entail any conclusion that the letters of comfort were inappropriate. The Authority recognised that funding commitments are likely to be contingent

⁴²⁷ Sumitomo Mitsui Banking Corporation Europe Limited, the Royal Bank of Scotland plc., National Australia Bank Limited, Lloyd's Bank Plc and the Commonwealth Bank of Australia.

⁴²⁸ NERA, Gas to the West, A report for the Utility Regulator p.21.

⁴²⁹ SIB – Letter to Uregni (2).

on, and related to the conditions of, the licence as granted; in particular on the terms of the price control which determine the value of the income stream that can be generated by the licence holder.

6.6.32 Moreover, the Authority did not consider that there was any ground for materially distinguishing between the weight to be placed on the comfort letters provided by PNGL and those provided by some other applicants. It accepted the advice of the Strategic Investment Board in this respect.

6.6.33 However, while accepting that a comfort letter indicates a willingness on the part of the relevant funder to participate in the project, the Authority considers that no material degree of weight can be attached to such letters for the purposes of demonstrating PNGL's cost of debt.

6.6.34 It follows that the PNGL proposed WACC for the mutual period lies outside the range of what, in the opinion of the Authority, could reasonably be expected for the G2W project. The Authority considered that there was significant uncertainty over whether PNGL would be able to raise finance at this rate, compounded by the general paucity of evidence provided by PNGL in relation to the derivation of the WACC figure, as indicated above. In the Authority's opinion, no degree of weight could be attached to the comfort letters provided that would be sufficient to overcome this fundamental difficulty with the assumptions made by PNGL.

6.6.35 Moreover, the Authority also noted that PNGL evidenced no previous experience of raising 100% debt in circumstances similar to those of the mutual period, and the existence of further questions over the assumptions made in relation to the establishment of a mutualisation model on which 100% debt financing depends (see further below).

6.6.36 Therefore the Authority was unable to conclude that the assumption that PNGL would be able to obtain financing to carry on the licensed activities on the basis of the proposed WACC was robust.

Transaction Costs

6.6.37 Second, the PNGL application made the assumption that the transaction costs associated with its funding structure should not be included in the WACC and could be treated as a pass through cost.

6.6.38 No information or evidence was presented in support of this assumption, and the Authority noted that no other applicant for the high pressure licence made any equivalent assumption. Indeed, the Authority considered that it is standard regulatory practice to include transaction costs within the WACC, and that this is consistent with the approach of the Competition Commission, Ofgem, Ofwat and the Authority itself.

6.6.39 The Authority therefore expected that transaction costs should be included in a proposed WACC, and would not consider them suitable for treatment as a pass through cost item. The Authority concluded that PNGL's assumption that they would be suitable for such treatment was not robust.

Gearing

6.6.40 Third, the PNGL application made the assumption that, during the mutual period, gearing will be 100%. In addition it assumed that the bond issued would achieve a strong investment grade rating (A/A1), and that this would then justify a low cost of debt.

6.6.41 PNGL provided no information or evidence as to the arrangements that would need to be put in place to achieve such a credit rating with a 100% debt capital structure. The Authority noted that previous such models in Northern Ireland have used liquidity reserves as a buffer to protect debt holders from losses, to consequently reduce their risk, and therefore to increase the credit rating. There was no evidence in the PNGL application of any understanding of these issues or plan for addressing them.

6.6.42 In consequence, the Authority considered that the PNGL application relied upon an internally inconsistent set of assumptions, since it simultaneously assumed a 100% gearing, no liquidity reserve and a high credit rating. The Authority did not consider that the combination of such assumptions could be regarded as robust.

Mutualisation

6.6.43 Fourth, the PNGL application indicated⁴³⁰ that the mutual period will commence once the high pressure assets had either been sold to MEL or transferred into a newly established company limited by guarantee. PNGL's proposed WACC in

⁴³⁰ HPOBP Phoenix High Pressure Operational Business Plan p.14.

- relation to the mutual period is entirely contingent on one of these events taking place, and for the purposes of the application PNGL has assumed that it will.
- 6.6.44 However, the Authority noted that no evidence was presented to suggest that any work had been carried out, even on a preliminary basis, to ascertain either the feasibility of these options or the costs involved in their delivery.
- 6.6.45 For example, to the extent that the application rested on the assumption of a sale to MEL, the Authority would have expected work to have been carried out, and evidenced, so that the application demonstrated an understanding of (and reflected) the costs and structure of previous asset sales to MEL.
- 6.6.46 The Authority noted that PNGL's proposed post-mutualisation WACC was very different from any previous costs of debt achieved on sales to MEL, and made no provision for matters such as a liquidity reserve (discussed above). Indeed, the considerable gap between (on the one hand) the PNGL proposed WACC following a putative sale to MEL and (on the other) the WACC proposed by MEL itself in the G2W competition appeared to the Authority to be indicative of the absence of any real consideration of the costs and consequences of such a sale.
- 6.6.47 To the extent that the application rested on the establishment of a new company limited by guarantee, which PNGL proposes (if required) would follow the MEL model and include a board of directors and members in place of shareholders, no information or evidence was provided as to the costs, process or issues that would be involved in setting up a new company limited by guarantee.
- 6.6.48 Overall, the Authority considered that the PNGL application relied fundamentally on assumptions made about the occurrence of a set of future events leading to the mutualisation of the high pressure network, while providing no information or evidence to demonstrate either the likelihood of those events taking place or that the costs and consequences of them had been taken into account.
- 6.6.49 In the absence of such information or evidence the Authority could not conclude that a WACC which is based on the assumption of that they will occur was based on an assumption that is robust.

Final Conclusion

- 6.6.50 Considering as a whole the evidence provided to support the proposed WACC,

NERA's view was that, given the limited information and evidence provided, it was not possible to conclude that the PNGL application was based on a robust set of assumptions⁴³¹. The Authority agreed with and accepted this conclusion.

Evidence verifiable from previous experience

- 6.6.51 The PNGL application used GD14 activity costs to build up a limited number of mobilisation costs. A considerable amount of work was carried out to determine the correct cost drivers and efficient costs for the purposes of GD14. Among other things this involved challenge from the Authority and public consultation.
- 6.6.52 Therefore the Authority regarded the evidence of the GD14 figures as a robust use of previous experience by PNGL⁴³².

Identification and quantification of risk

- 6.6.53 The PNGL application recognised that between the time at which the application was made and the date any corporate bond would be issued, conditions in the financial markets were likely to have changed and consequently there was a risk that the actual WACC could be different to that presented in the application.
- 6.6.54 The application⁴³³ also highlighted that it may not in fact be possible for PNGL to raise funds using the proposed mutual model, and indicated that in these circumstances PNGL would consider moving to a revenue cap model with a new WACC. However, no information was provided as to the probability of this situation arising, nor was there any analysis of the impact this could have on the WACC. Given the discussion elsewhere in the application of using impact and probability⁴³⁴ in assessing risks the Authority would have expected such analysis to have been presented.
- 6.6.55 The Authority considered that both of the risks noted above were appropriately identified, but neither of them was quantified in terms of probability or impact.
- 6.6.56 Overall the Authority considered the identification and quantification of risk to be limited. The Authority would have expected the application to directly address

⁴³¹ NERA 2.2.7 p. 7 & 3.2.3 p. 13.

⁴³² HPOBP Phoenix High Pressure Operational Business Plan – Chapters 1 –9 p. 49.

⁴³³ HPOBP Phoenix High Pressure Operational Business Plan p.244.

⁴³⁴ HPOBP Phoenix High Pressure Operational Business Plan p.99.

the risks of each cost line with consideration given to the likelihood and impact of the risks and some discussion on possible mitigation measures in each case.

Efficiency improvement plan

- 6.6.57 PNGL provided an efficiency improvement plan⁴³⁵ which referenced the activities being carried out on an existing low pressure network. It outlined how PNGL uses benchmarking, Business Improvement Plans, and the Group Development Forum to deliver efficiency improvements.
- 6.6.58 The Authority considered that the efficiency improvement plan was weak in the context of an application for a high pressure licence, with little information or evidence presented of specific plans or programmes to improve the efficiency of operation of a high pressure pipeline.

Final mark for sub-criterion 3.17(b)

- 6.6.59 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the PNGL application should attract a low score, and its final decision is to award 4 out of 20 marks, in relation to sub-criterion 3.17(b).
- 6.6.60 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.
- 6.6.61 By comparison with the other applications, the Authority considered the PNGL application to have been significantly the weakest in respect of this sub-criterion, a view supported by the advice received from NERA. To a large extent, this was a reflection on the paucity of information and evidence provided by PNGL. Little descriptive support was provided for its derivation of key data in almost all areas. Fundamental assumptions were made that did not appear to be robust in their own terms and were unsupported by any evidence adequate to justify them. In particular, PNGL proposed a WACC that was outside NERA's 'plausible range' and required a considerably fuller justification, but was in fact much less well explained than the more conventional WACC proposals of other applicants; not only that of NIEH (which set a high standard for describing the derivation of its

⁴³⁵ HPOBP Phoenix High Pressure Operational Business Plan p.229.

data) but even that of BGE(UK) (which did not).

6.7. Specific Criteria – Operational Business Plan 3.17(c)

The experience of the applicant and others on whom it intends to rely in relation to network construction

- 6.7.1 PNGL stated that it was responsible for constructing, operating and maintaining the Belfast Gas Transmission network for a period of around 12 years from 1996 until it was sold in 2008. It stated that although it has not been directly involved in gas transmission activities over the last few years, key personnel who were previously responsible for transmission are still employed by the company⁴³⁶. However, those members of staff were not named, nor were any curricula vitae provided listing their skills and experience.
- 6.7.2 The Authority noted that PNGL's experience in relation to the construction of high pressure networks is not recent and the majority of experience discussed in its application is in relation to low pressure networks⁴³⁷.
- 6.7.3 The Authority also noted that although PNGL stated that some of its current staff have previous experience in relation to constructing high pressure networks, it was not indicated what (if any) role such persons would play in the construction of the high pressure network to which the licence relates.
- 6.7.4 In order to construct the network PNGL will therefore be primarily dependent on external resources and the recruitment of a number of significant roles such as the PMC.
- 6.7.5 As indicated above in relation to the assessment under sub-criterion 3.17(a), The Authority would have expected to be provided with evidence of the skills and expertise of persons already appointed or proposed to be appointed to the relevant roles. However, as such persons have not been recruited, PNGL was unable to provide details of the skills and experience of the persons who will undertake these key roles. The Authority was therefore unable to undertake any

⁴³⁶ Ibid, pp. 11 – 12.

⁴³⁷ See for example, ibid, section 3.6, p.58.

assessment of the skills and experience of those persons on whom PNGL will be required to rely.

- 6.7.6 The Authority concluded that PNGL had demonstrated limited experience, none of which was recent, in relation to managing the processes and resources that are necessary to construct a high pressure network, and that it was unable to assess the experience of any person on whom PNGL will seek to rely for this purpose since no details of such persons were provided.

The experience of the applicant and others on whom it intends to rely in relation to network operation

- 6.7.7 PNGL stated that it had 12 years' experience in the operation of high pressure pipelines in the period between 1996 and 2008 when it owned the Belfast Gas Transmission network⁴³⁸. Again, the Authority noted that this experience was not recent, and that if the relevant experience still resides within PNGL in the person of experienced staff this was neither described nor evidenced in its application. The Authority did not consider that this could be regarded as self-evident in the case of a company which disposed of its high pressure business several years ago.
- 6.7.8 The application indicated that PNGL has an existing control room which is used to monitor and control its low pressure distribution system. However, it appears from the OBP that relevant high pressure IT systems (such as SCADA, GTMBS and cathodic protection monitoring) are not currently maintained in-house within PNGL and would need to be procured⁴³⁹. PNGL asserted that it is capable of carrying out the required high pressure functions in-house⁴⁴⁰, but this statement was not supported by any accompanying explanation or evidence.
- 6.7.9 The application stated that PNGL uses the Governor Maintenance Database for asset management and that this could be adapted for the new high pressure system⁴⁴¹.

⁴³⁸ Ibid, section 1.2 and p.143.

⁴³⁹ Ibid, p.55.

⁴⁴⁰ Ibid, p.55.

⁴⁴¹ Ibid, p.57.

6.7.10 Overall, the Authority considered that PNGL had provided limited information in relation to its experience of operating high pressure networks, none of which is current or recent.

6.7.11 This conclusion was supported by the report from Rune.⁴⁴²

Securing, mobilisation and management of resources

6.7.12 PNGL provided limited details of its proposals to secure, mobilise and manage the internal and external resources necessary for the construction of the high pressure network. This is primarily because PNGL is dependent on securing and mobilising external resources, and in particular recruiting a competent PMC prior to the securing of other necessary resources, and it has not yet done so⁴⁴³.

6.7.13 The application indicated that key people would need to be recruited, notably the PMC, but was inconsistent in its description as to when that would happen⁴⁴⁴.

6.7.14 The Authority considered that although the application reflected a necessary focus on the securing and mobilisation of resources, inadequate detail was provided as to the means by which this would take place.

6.7.15 Similarly, as above in relation to sub-criterion 3.17(a), the Authority considered that although PNGL provided a high level description of its current tendering arrangements, and stated that it would use these in relation to the construction of the network, the OBP lacked detail on how the use of existing arrangements would be tailored to the latter.

6.7.16 The Authority also noted that PNGL does not have experience of tendering for the construction of a high pressure pipeline and that there is limited evidence that it has appropriate framework contracts in place which it could utilise. The advice from Rune suggested that there was limited evidence that PNGL understands the procurement requirements associated with the construction and maintenance of high pressure pipelines.

⁴⁴² Gas to the West Technical Advice on High Pressure Submissions, RUNE Associates, p.8.

⁴⁴³ See for example section 3.2 of the PNGL, op cit, which illustrates the focus on recruitment.

⁴⁴⁴ Ibid, p. 20 and p.36 indicate that PNGL will begin the process to appoint the PMC upon award of licence, while p.41 and p.74 indicate Phoenix will begin the process upon announcement of the Preferred Applicant.

- 6.7.17 In addition, the Authority noted that procurement of some of the required materials will be the responsibility of the construction contractor which, as noted above, has not yet been identified. The Authority was therefore unable to assess either the experience of the construction contractor in undertaking such procurement or the systems and processes which it might have in place to do so.
- 6.7.18 The application indicated that PNGL assumes that an appropriate IT system will be delivered by the single Transmission System Operator (**TSO**). However, if arrangements for the single TSO are not completed in time, PNGL would have to upgrade the current control room to accommodate the IT systems necessary for the high pressure pipelines. Therefore SCADA, GTMBS, Site Security Systems and the Cathodic Protection Monitoring System would need to be procured.⁴⁴⁵
- 6.7.19 Overall, the Authority considered that PNGL provided only limited information in regard to its proposals for internal mobilisation. The application was based on PNGL's securing and mobilisation of external resources, but there is a paucity of detail regarding the means by which this could successfully be achieved.
- 6.7.20 This conclusion was supported by the report from Rune⁴⁴⁶.

Engagement with stakeholders

- 6.7.21 As noted above, the Authority considers there to be substantial overlap between sub-paragraphs 3.17(a)(i) and 3.19(g) of the Criteria. The Authority's analysis of PNGL's application under sub-paragraph 3.17(a)(i) is therefore of relevance and is adopted as part of the Authority's assessment here.
- 6.7.22 PNGL provided a list of stakeholder organisations with which it currently engages, together with a high level description of its current engagement activities which include an annual programme of ongoing engagement. It also briefly described the channels through which it communicates with stakeholders and cites social media and YouTube in this regard alongside direct meetings⁴⁴⁷.
- 6.7.23 In relation to the G2W project, PNGL stated that as part of any design and construction work it will engage with a range of external stakeholders from

⁴⁴⁵ Ibid, p.56.

⁴⁴⁶ RUNE Associates, op cit, p.9 and p.10 and p.15.

⁴⁴⁷ PNGL, *High Pressure Operational Business Plan*, pp. 210 – 11.

statutory bodies to local interest groups and potential customers⁴⁴⁸. It provided a list of ten specific stakeholders with which it will engage⁴⁴⁹, three of which it went on to discuss at a high level: namely the Roads Service, Local Councils and *'other utilities'*⁴⁵⁰.

- 6.7.24 As noted in Chapter 2 of the provisional decision paper, sub-paragraph 3.19(g) contains a degree of specificity which is not contained in sub-paragraph 3.17(a)(i), as it refers to proposals in relation to particular groups of stakeholders which the latter does not. Those groups are identified as *'all relevant regulatory authorities and statutory agencies, other licence holders and private entities necessary to construct a high pressure network'*.
- 6.7.25 Of the ten stakeholders referred to by PNGL, five are statutory agencies and reference is then made to *'other utilities'*.
- 6.7.26 With regard to *'private entities'*, PNGL stated that it will appoint land agents who will visit each landowner/tenant to explain the project in general terms and the consenting process⁴⁵¹. It also stated that an Agricultural Liaison Officer will liaise with farmers and landowners on a daily basis to listen to and rectify any concerns they may have, in particular where they believe construction activities may be interfering with farming activities⁴⁵².
- 6.7.27 The Authority noted that little information was provided regarding a track record of dealing with landowners, and that PNGL's proposals lacked detail in regard to its experience of, and plans for, engagement with this key stakeholder group. PNGL proposals for dealing with landowners indicated that the role of the PMC will be important – the PMC will appoint land agents⁴⁵³ and will prepare wayleave plans⁴⁵⁴.
- 6.7.28 Overall, the Authority considered that while PNGL provided some useful details of its proposals for engagement with stakeholders, those proposals were limited

⁴⁴⁸ Ibid, p. 59.

⁴⁴⁹ Ibid.

⁴⁵⁰ Ibid, pp. 59 – 61.

⁴⁵¹ Ibid, p.71.

⁴⁵² Ibid, p.81.

⁴⁵³ Ibid, p. 71

⁴⁵⁴ Ibid, p. 72.

both generally and in relation to the specific stakeholders identified in paragraph 3.19(g).

Timely delivery of the high pressure network

- 6.7.29 The application indicated that PNGL has some previous experience of high pressure pipeline construction.
- 6.7.30 PNGL stated that it has engaged external advisors, Penspen Limited and RPS Ireland Limited, to assist in the development of a high level programme. It stated that these advisors have considerable experience in the field of high pressure pipeline design, construction and commissioning ranging from environmental impact assessments to planning applications and project management, with both companies having operated as a Joint Venture 2003 to 2007 for BGE(UK) in relation to the South North Pipeline⁴⁵⁵.
- 6.7.31 A programme for delivery of the proposed activities was provided at Table 1 of the OBP. This specified the various key activities and the time planned for completion of each activity within a three year programme. In addition, section 3.1 of the OBP provided high level information describing the key activities covered by the programme to achieve commissioning of the high pressure pipeline within this timeframe.
- 6.7.32 The report from Rune stated that the proposed programme over a three year period has a degree of credibility as it was developed with support from external advisors⁴⁵⁶. However, the Authority had reservations as to whether the plan could be delivered on the basis of its consideration of other aspects of PNGL's application; the proposed financing arrangements, absence of key IT systems, and need to recruit the key role of project manager increase the risk that the plan as outlined will not be capable of delivery.
- 6.7.33 Section 3 of the OBP outlined various risks to the completion of the pipeline and actions to mitigate these risks were described. The Authority considered that PNGL had demonstrated that it has a robust policy for the identification and management of risks, and in addition that there was some evidence that this

⁴⁵⁵ Ibid, p. 31.

⁴⁵⁶ RUNE Associates, op cit, p.18.

approach had been applied to identify a limited number of specific risks relating to the G2W project and provide for their mitigation.

6.7.34 However, the Authority noted that no evidence was presented of any relevant experience on the part of PNGL regarding the identification and management of risk in relation to the construction of a high pressure pipeline.

6.7.35 In its assessment of the matters arising under this heading the Authority also had regard to PNGL's proposals to substitute high pressure pipelines with low pressure pipelines. Those proposals were detailed and the report from Rune stated that they were credible and included an indication of possible capital expenditure reductions⁴⁵⁷. The Authority considered that this had potential value which should be taken into account.

Measures to protect customers in the context of operating cost pass through

6.7.36 As noted above, the PNGL application was based on an operating cost pass through model. The Authority therefore considered what information PNGL had provided in relation to measures to protect customers in the context of operating cost pass through. The Authority considered this to be an important matter to which it should give some weight, in accordance with the customer protection element of its duties under Article 14 of the Energy Order.

6.7.37 On consideration, the Authority found that the application provided little evidence that PNGL had considered appropriate measures to protect customers in the context of an operating cost pass through licence.

6.7.38 As noted above, PNGL proposed that after the initial interim period it will set up a new company limited by guarantee or sell the high pressure network to NIEH (or alternatively seek a renegotiation of its licence with the Authority)⁴⁵⁸.

6.7.39 The level of protection for customers after the interim period was therefore based on PNGL's proposal either to sell the company to MEL or set up a company limited by guarantee which would have governance arrangements similar to

⁴⁵⁷ Ibid, p. 15.

⁴⁵⁸ PNGL, op cit, p. 244.

arrangements such as Premier Transmission's⁴⁵⁹. The Authority considered this to be a reasonable proposal in principle, though limited detail was provided in relation to it.

6.7.40 However, the Authority considered that PNGL did not evidence how customers would be protected in the interim period prior to mutualisation and during which time there would still be operating cost pass through under its proposals. This was particularly important given the limited information and therefore uncertainty around PNGL's proposals for mutualisation, as described above in relation to sub-criterion 3.17(b).

6.7.41 In particular, given the absence of any detailed plans in relation to mutualisation, the Authority considered that there was uncertainty relating to the timetable for it to take place; this made it important that there should be adequate assurance that customers would be protected in the interim period, which may be extended if mutualisation did not occur or was delivered later than proposed.

6.7.42 The Authority concluded that there was limited evidence in the application that PNGL had appropriately recognised the customer risk inherent in its structure, and that the application was especially weak in its failure to consider the need to make arrangements to protect customers in the interim period or to put forward any adequate proposal for that period.

PNGL final mark for sub-criterion 3.17(c)

6.7.43 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the PNGL application should attract a low score, and its final decision is to award 7 out of 20 marks, in relation to sub-criterion 3.17(c).

6.7.44 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.

6.7.45 By comparison with the other applications, as in relation to sub-criterion 3.17(a), the Authority considered the PNGL application to have provided limited evidence of skills and experience relating to high pressure networks (both their operation

⁴⁵⁹ PNGL, op cit, p. 18.

and construction). PNGL's proposals for mobilisation indicate that it is primarily reliant on skills and experience sourced externally; however, it has yet to make arrangements to do so and the required PMC cannot be identified or assessed. In addition, many of the key systems needed are not in place, and for a company proposing a cost pass through model there were no adequate proposals for the protection of customers in the 'interim period'. However, PNGL was given some credit for the evidence suggesting that a detailed review had been undertaken in relation to its proposals to substitute high pressure pipelines with low pressure pipelines, including indications of possible capital expenditure reductions; one other applicant had raised the same point but PNGL's alternative design was the most credible.

6.8. Specific Criteria – Innovation & Technology

- 6.8.1 PNGL addressed innovation and technology transfer in a standalone document submitted as part of its application (the ITT).
- 6.8.2 The same document was used as part of PNGL's applications for both the high and low pressure licences and not tailored to either application specifically. Many of the examples cited were largely applicable to low pressure pipelines.
- 6.8.3 The ITT did not systematically address the matters listed in paragraph 3.21 of the Criteria. Instead it sought to demonstrate a history of innovation within PNGL, the factors driving the delivery of innovation, and outputs such as cost efficiencies.

Environmental sustainability

- 6.8.4 The ITT did not address environmental sustainability directly and provided limited information in relation to PNGL's ability to achieve innovation and technology transfer in this respect.
- 6.8.5 PNGL stated that it is working with a consortium to explore the opportunities around biomethane being injected into the natural gas grid in Northern Ireland⁴⁶⁰.

⁴⁶⁰ PNGL, *Gas Network Extensions in Northern Ireland: Gas to the West ("GTW"): Phoenix Innovation and Technology Transfer*, p 16.

It is also exploring the possibility of running its own vehicle fleet on compressed natural gas (CNG)⁴⁶¹. Little detail was provided in relation to either initiative.

- 6.8.6 The Authority considered that it could give little weight to these examples as they were supported by limited information and their relevance within the context of an application for a high pressure network licence was limited.

Efficiency in use of gas and new sources of gas

- 6.8.7 The ITT did not address efficiency in the use of gas directly. In relation to the use of new sources of gas, the exploratory use of biomethane discussed above was referenced, but no details were provided which would allow the Authority to assess the proposal.
- 6.8.8 The Authority noted PNGL's statement that one outcome from the introduction of pre-assembled meter installation is a reduction in gas leakage⁴⁶².
- 6.8.9 Again, the Authority considered that it could give little weight to these examples as they were supported by limited information and their relevance within the context of an application for a high pressure network licence was limited.

Cost efficiency

- 6.8.10 The ITT provided details of a number of projects, and identified cost savings for some of them. One example was the introduction of smaller directional drilling rigs in urban areas which PNGL estimates has saved approximately £20m compared to traditional open cut methodologies.⁴⁶³ Another is the use of a 4bar MP network and direct connection of properties to the network (a practice which differs from standard practice in Great Britain). PNGL stated that a conservative estimate of the savings in construction cost delivered by these two innovative approaches to date was approximately £40m⁴⁶⁴.
- 6.8.11 While the Authority considered that PNGL had therefore provided some helpful information in relation to its ability to innovate in relation to cost efficiency, it noted that the examples given were largely applicable to low pressure pipelines;

⁴⁶¹ Ibid.

⁴⁶² Ibid, p. 7.

⁴⁶³ Ibid, p.8.

⁴⁶⁴ Ibid, p.5.

this limited the weight that could be attached to them within the context of an application for a licence relating to a high pressure network.

- 6.8.12 The Authority would have expected a much greater effort to be made to draw out relevant points from these examples to demonstrate the ability to innovate in relation to the network licence to which the application relates.

The development of the network to more remote geographical areas

- 6.8.13 The ITT discussed the development of the gas network in relation to the licence by referring to PNGL's application for the licence in respect of the low pressure network as evidence of how PNGL would develop the new licensed area.
- 6.8.14 Specific proposals in relation to the high pressure network were very limited and there was no discussion of how the examples relating to low pressure networks were relevant in the context of the high pressure network to which the licence application relates.

History of innovation

- 6.8.15 The ITT outlined a number of PNGL innovations. However, the examples given were again largely applicable to low pressure pipelines.
- 6.8.16 The Authority attached some weight to these examples as demonstrations of an ability to innovate generally. However, it would have expected a greater effort to be made to draw out relevant points from these examples to illustrate the ability to innovate in relation to the network licence to which the application relates.
- 6.8.17 Therefore limited weight was given to these examples as their relevance within the context of an application for a high pressure licence was not clear.

Ability to secure funding

- 6.8.18 The ITT stated that PNGL has previously secured funding from the Department of Learning, Energy and Utility Skills and the Construction Industry Training Board to support training and accreditation for its staff⁴⁶⁵.
- 6.8.19 The ITT also pointed to the fact that PNGL has worked effectively with local government to promote the benefits of converting to natural gas and stated that this approach has resulted in local government introducing funding which supports connections, such as NIHE funding for heating system conversions⁴⁶⁶.
- 6.8.20 The Authority considered that PNGL had provided some evidence of its ability to secure funding. However, the examples provided have not been of funding to support innovation and therefore were of limited relevance. This was also noted in the advice received from Rune which concluded that 'there is no direct evidence of securing funding for innovative developments' ⁴⁶⁷.

Transfer of innovation into Northern Ireland

- 6.8.21 The ITT set out no substantive proposals to transfer any innovation into Northern Ireland. Rather it proposed the transfer of innovation within Northern Ireland from its existing licensed area (which relates to low pressure) to the new licensed area. This was also noted in the advice received from Rune⁴⁶⁸.
- 6.8.22 The ITT mentions that PNGL is committed to exploring CNG opportunities in the new licensed area and that if biomethane can be injected into the network then it could be transported to any customer connected to the network⁴⁶⁹. However, little detail was given in relation to these proposals.
- 6.8.23 The Authority did not consider that the application substantially addressed the issues required to be considered by it under this heading.

Existing skills and experience

- 6.8.24 The existing skills and experience of PNGL staff in relation to innovation were not detailed in the application. Instead the ITT discussed PNGL's existing

⁴⁶⁵ Ibid, p.14.

⁴⁶⁶ Ibid, p. 20.

⁴⁶⁷ RUNE Associates, op cit, p. 25.

⁴⁶⁸ Ibid.

⁴⁶⁹ PNGL, op cit, p.16.

approach to staff development generally and stated that the approach described will be duplicated within the new licensed area⁴⁷⁰.

6.8.25 As noted in Chapter 2, sub-paragraph 3.21(b)(iv) of the Criteria refers to 'existing skills and experience'. The Authority therefore considered that it was able to give no credit under this heading in respect of any skills or experience which may be gained by staff in the future.

6.8.26 However, the Authority recognised that there is some overlap between this sub-paragraph and sub-paragraph 3.21(b)(i), as evidence of a history of innovation is one way in which skills and experience may be demonstrated.

Final Conclusion

6.8.27 The Authority considered that some credit should be given to PNGL for the examples of innovation that it presented in its application. However, generally the Authority considered that limited weight should be attached to those examples, since even those which were adequately detailed were largely applicable to low pressure pipelines, and the ITT made no attempt to illustrate how they demonstrated skills and experience which were of relevance to innovation in the materially different context of high pressure pipelines.

Final mark for the ITT sub-criteria

6.8.28 Having regard to the application and in particular to the matters identified above, the Authority confirms that the PNGL application should attract a low score, and its final decision is to award 7 out of 20 marks, in relation to the ITT sub-criteria, to be allocated equally between sub-criteria 3.21(a) and (b) as explained in Chapter 2 of the provisional decision paper.

6.8.29 The Authority compared this mark with those awarded to the other high pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.

6.8.30 By comparison with the other applications, the Authority considered the PNGL application to have provided limited evidence of its ability to achieve innovation

⁴⁷⁰ Ibid, pp.13 - 14.

and technology transfer when set against that of MEL. PNGL's application was more closely comparable to that of BGE(UK). However, the PNGL submission on ITT attracted a lesser mark than BGE(UK) because it was identical to that within its low pressure licence application, and based very largely on low pressure experience, with little to demonstrate why this would be relevant in a high pressure context and few high pressure proposals. As to some of the matters to be considered by the Authority no relevant evidence was given.

6.9. Resources Criteria

- 6.9.1 Having carried out a detailed analysis of the PNGL application, and in particular considered the OBP for the purpose of awarding marks under sub-criteria 3.17(a) to (c), the Authority then considered whether PNGL meets each of the Resources Criteria.
- 6.9.2 As described in Chapter 2 of the provisional decisions, and for the reasons set out there, this entailed taking the Resources Criteria out of the formal sequence in which they appear in the Criteria, and considering them as a final check on the application as a whole; following, and drawing on the detail, of the analysis of the OBP.
- 6.9.3 On this basis, for the purposes of these two criteria, the Authority carried out an overall assessment of the information and evidence that was revealed by the PNGL application in relation to the adequacy of its resources.
- 6.9.4 More specifically, the Authority:
 - a. considered carefully whether PNGL has demonstrated that it has, or is making appropriate arrangements to obtain, the resources required to meet the obligations to be included in the conditions of the high pressure licence (the Adequate Resources Criterion); and
 - b. considered in particular whether PNGL has demonstrated that it has the resources and financial standing to undertake the activities to be carried out for the purposes of meeting those obligations (the Financial Resources and Standing Criterion).

- 6.9.5 For these purposes, the Authority had particular regard to whether PNGL has demonstrated that it will have the financial resources for the construction of the high pressure network while being subject to a revenue restriction that reflects the financial terms of its application. This will constitute the most substantial obligation of any applicant which is successful in obtaining the licence.

Assessment following sub-criteria 3.17(a) to (c)

- 6.9.6 In carrying out this assessment, the Authority began with the marks awarded by it in relation to sub-criteria 3.17(a) to (c).
- 6.9.7 As indicated above, PNGL was awarded a 'low' score in respect of each of these sub-criteria.
- 6.9.8 In aggregate, once the relevant marks were given their appropriate weighting for the purposes of the Best Value Criterion, PNGL obtained 26.5% of the available marks in relation to the sub-criteria. In respect of the financial information and evidence considered under sub-criterion 3.17(b), it obtained 20% of the available marks.
- 6.9.9 The Authority concluded that these scores were consistent with an application which, when taken in the round, provided only limited evidence, explanation or justification in support of PNGL's assertion that it meets the requirements of the Criteria. As explained in Chapter 2 of the provisional decisions, this immediately calls into question whether the application demonstrated that the Resources Criteria are met, and requires that issue to be looked into further.
- 6.9.10 The Authority's assessment of the quality of information and evidence submitted in the OBP is set out above, and need not be repeated here in full. However, some broad themes can be drawn from it.
- 6.9.11 Two persistent features of PNGL's application were disclosed by the Authority's analysis: paucity of evidence, and reliance on assumptions as to future events.

Paucity of Evidence

- 6.9.12 The Authority considered that there was a paucity of evidence provided as part of the OBP.

- 6.9.13 Some factors which fell to be evidenced under these sub-criteria were either adequately or well-supported by information provided by PNGL. They are noted in the relevant sections above and were given appropriate credit in the marks awarded.
- 6.9.14 However, the majority of relevant factors were not supported by the detailed information and evidence that the Authority would expect to have seen in a well-evidenced application. In relation to some factors listed for consideration under these paragraphs, PNGL provided no information at all.
- 6.9.15 The Authority regards it as fundamental to its interpretation of the Criteria that in respect of both the Resources Criteria and the Best Value Criterion, the onus lies on the applicant to demonstrate, by the information and evidence submitted, that it meets the criteria.
- 6.9.16 This has been expressed elsewhere in this document as the 'evidential burden' which lies on each applicant. It is intrinsic to both the Resources Criteria and the Best Value Criterion.
- 6.9.17 In the case of the Resources Criteria, it is expressly specified as a feature of the criteria that they are only met if the applicant demonstrates to the satisfaction of the Authority that the required resources are available. In the case of sub-criteria 3.17(a) to (c), the requirement on the Authority is specifically to consider only the information and evidence in the OBP for the purposes of its scoring.
- 6.9.18 The Authority could not attribute marks to PNGL under sub-criteria 3.17(a) to (c) in the absence of information and evidence which justifies it doing so. Nor could it make assumptions about the sufficiency of PNGL's resources for the purposes of the Resources Criteria where the evidence base is incomplete or inadequate.
- 6.9.19 In order to 'demonstrate' that the required resources are available to it, or that it is taking appropriate steps to ensure that they will be, PNGL in its application was required to provide sufficient information or evidence for the Authority to be satisfied on these matters.
- 6.9.20 With regard to systems, apparatus, human and other resources, the overarching conclusion reached by the Authority was that PNGL provided evidence which, through its incompleteness, lack of detail, or suitability mainly in a low pressure

context, gave only a very limited indication of the adequacy of its resources in respect of a high pressure network licence.

- 6.9.21 The Authority considered it inherently credible that PNGL, as an established gas network operator with in-house systems and expertise relating to low pressure networks, could obtain the skills, experience, systems and other resources that it requires for the purposes of constructing and operating a high pressure network. However, this would require it to acquire additional resources externally. There was limited (or, in relation to some matters, no) evidence that PNGL has taken, or is taking, the appropriate steps to do so. Advice provided to the Authority by Rune called into question whether PNGL currently has the understanding of high pressure networks sufficient to procure these resources.
- 6.9.22 PNGL proposes to recruit a PMC in order to fill a role fundamental to the delivery of the licensed activities. However, the Authority considered that, on a proper application of the Criteria, it could attach only limited weight to a statement of future intent to recruit a PMC who cannot at present be identified and therefore whose capabilities cannot be evaluated for the purposes of the competition.
- 6.9.23 With regard to financial resources and facilities, the Authority considered that the questions as to PNGL's application were even more fundamental.
- 6.9.24 In its application PNGL proposed, after an initial 'interim' period, a WACC of 1% for a 100% debt financed company. This figure attributable to the 'mutual period' which is projected to commence around two years after the grant of the licence is included in the Data Input Workbook and therefore influences the calculations of the marks awarded for the Applicant Determined Costs sub-criterion. It is important that it is an adequately supported figure, demonstrating that PNGL can reasonably be expected to be able to obtain funding at that cost of debt.
- 6.9.25 However, a WACC of 1% would require PNGL to achieve a cost of debt that has no precedent in the Authority's experience, falls below the lowest point of the 'plausible range' established by NERA and is approximately half the figure that NIEH (an established mutualised company within the Mutual Energy Group to which PNGL would propose to sell the high pressure network) has itself specified for the purposes of its application.

- 6.9.26 None of these facts by themselves means that a WACC of 1% is not achievable. The Authority considers, however, that they call into question its credibility. In the context of a proposed WACC which falls outside the range that might reasonably be expected, the Authority would, in order to be satisfied that financing could be obtained at such a cost of debt, have expected to see a thorough, detailed and complete description of its build up with full supporting evidence.
- 6.9.27 The Authority considered that what was in fact presented by PNGL in its OBP did not meet this expectation, for all the reasons outlined more fully in relation to sub-criterion 3.17(b) above.
- 6.9.28 PNGL's description of how the proposed WACC was derived would have been awarded a low mark regardless of the figure proposed. A comparison between PNGL's application and that of NIEH serves to indicate what kinds of information and evidence can be provided to robustly explain and underpin the build-up of a proposed WACC. However, the Authority concluded that there was a particularly significant disparity between what was provided by PNGL and what would have been required to demonstrate the credibility of a WACC outside the plausible range.

Reliance on Assumptions as to Future Events

- 6.9.29 A related issue identified by the Authority was the number of key factors, to be considered under the Criteria, in relation to which PNGL relied on statements as to contingent future events about which there can be no certainty.
- 6.9.30 In these cases PNGL invited the Authority to have regard not to arrangements that are currently in place, nor even to arrangements that are in the process of being made, but to events that it is said may or will occur in the future.
- 6.9.31 As explained in Chapter 2 of the provisional decisions, it is not a feature of the Criteria that an applicant is required to have all of its resources in place at the time of its application. All of the applicants for the G2W licences have indicated to some extent the need to recruit staff or engage contractors for the purposes of performing the licensed activities.
- 6.9.32 However, the Adequate Resources Criterion requires applicants to demonstrate to the satisfaction of the Authority that where they do not have the required

resources they are making appropriate arrangements to get them, and the Authority can give little if any weight to statements about the future which relate to arrangements with individuals or bodies which cannot currently be identified or evaluated.

- 6.9.33 As indicated above, the Authority considered that PNG's application depended to a significant degree on statements as to its future intent to obtain the required resources from persons whose identities are not presently known.
- 6.9.34 In addition, PNG's application is reliant on other types of future event which have a particular bearing on its proposals as to financing.
- 6.9.35 As explained more fully above, it is fundamental to PNG's financing proposal that after an initial 'interim' period it proposes a 'mutual' WACC which is 100% debt financed. The application stated that this WACC will be 1%, and that figure lacks adequate support for the reasons already given. However, if it were to be achieved at all, PNG indicated that the assets would first need to be mutualised by their sale to MEL (its preferred option) or the creation of a mutual entity by PNG itself.
- 6.9.36 If neither of these events takes place, the third option is that PNG will need to return to the Authority to renegotiate the WACC.
- 6.9.37 The events referred to therefore appear to be contingent on the occurrence of future events over which PNG has limited control and/or in relation to which it appears to have taken no current steps towards delivery.
- 6.9.38 The Authority did not consider that, consistent with the terms of the Criteria or indeed with sound regulatory practice, it could attribute any material degree of weight to statements of future intent which are not based on evidence as to what arrangements currently exist or are in the process of being established.
- 6.9.39 Assertions as to possible future events were therefore not a substitute for the evidence of the type that the Authority would expect to have seen in the application, and to the extent to which they are relied upon by PNG they were considered by the Authority to reflect a weakness in the evidence base on which its application rests.

Final conclusion

- 6.9.40 The effect of the matters highlighted above was that the Authority was not able to have sufficient confidence in the information and evidence provided to it in the PNGL application to conclude that PNGL meets the Resources Criteria.
- 6.9.41 The Authority concludes that PNGL has not demonstrated to its satisfaction that it either currently has, or is making appropriate arrangements to ensure that it would have in place by the time it would commence regulated activities under the high pressure licence (if granted), the financial and other resources likely to be sufficient for the purposes of meeting its obligations under the conditions of that licence.
- 6.9.42 The Authority also concludes that PNGL had not demonstrated that it has the resources and financial standing to undertake the activities to be carried out for the purposes of meeting those licence obligations.
- 6.9.43 While a number of elements of the application were assessed as evidentially weak and therefore attracted a low score, the decisive factor in these conclusions was the paucity of evidence relating to the proposed 'mutual period' WACC. The Authority could not be satisfied that PNGL had demonstrated that it could obtain finance at the cost of debt specified, even on the assumption that it was effectively able to mutualise the high pressure assets.
- 6.9.44 None of these conclusions should be taken to imply any further conclusion that PNGL would be unable to construct and operate the G2W high pressure network in compliance with the conditions of the licence. The Authority has concluded only that PNGL has failed to demonstrate that it could do so.

7.0 firmus Low Pressure Connected

7.1. Introduction

7.1.1 This chapter:

- a. considers the application made by firmus energy (Distribution) Ltd (**firmus**) for the low pressure licence, which is connected to the BGE (UK) application for the high pressure licence;
- b. the responses received to the consultation on the provisional decisions, as these relate to the connected application made by firmus
- c. sets out the Authority's final conclusions as to whether firmus has met each of the criteria other than the Best Value Criterion;
- d. sets out the Authority's final assessment of the marks to be awarded to firmus in respect of the different elements of the Best Value Criterion;
- e. explains the reasons of the Authority for its final conclusions and marks.

7.1.2 In this chapter, the criteria have been addressed in the order in which they are set out in Chapter 2 of the provisional decisions, and the Authority has followed the approach to interpreting and applying the criteria that is set out in that chapter.

7.2. The Information Criterion

7.2.1 Both an electronic and a printed copy of the firmus application were received by the Authority before the deadline of noon on 6 May 2014

7.2.2 Once the deadline had passed the application was opened and checked for completeness against a pre-prepared checklist. The application was assessed as being complete except in two respects:

- a. it was not clear from the application what information was being relied on by firmus for the purposes of meeting the Adequate Resources Criterion;

and

- b. it was not clear from the application what information was being relied on by firmus for the purposes of meeting the Financial Resources and Standing Criterion.
- 7.2.3 firmus was informed of these apparent omissions and was given until noon on 14 May 2014 to provide the missing information. A response was received by the deadline and it was subsequently judged that this addressed the omission in full⁴⁷¹.
- 7.2.4 Having considered these facts, the Authority concluded that firmus has provided all the information requested by the Authority, in such manner and by such times as was specified, and therefore meets the Information Criterion.

7.3. The Constitution Criterion

- 7.3.1 firmus is a limited company with its registered office in England. firmus's constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations⁴⁷².
- 7.3.2 Having considered this evidence, the Authority was satisfied that firmus has demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.

7.4. The Fit and Proper Person Criterion

- 7.4.1 Evidence to demonstrate that firmus is a fit and proper person was provided to the Authority in accordance with paragraphs 20 to 26 of Schedule 2 to the Application Regulations⁴⁷³. It consisted of a signed statement by a senior officer of firmus to the effect that firmus had no information to disclose under any of those paragraphs.

⁴⁷¹ Response to UR 14 May (3)

⁴⁷² Connected Application Form and Appendix 1 Connected Application Form (ICON) Ownership

⁴⁷³ Ibid

7.4.2 The Authority noted that firmus has no record of enforcement action being taken against it, or any other adverse factor of the type listed in the Application Regulations.

7.4.3 On the basis of the evidence provided to it, the Authority was therefore satisfied that firmus meets the Fit and Proper Person Criterion.

7.5. Specific Criteria – Operational Business Plan 3.17(a)

Engagement with stakeholders

7.5.1 In section 1.2 of its OBP, firmus states that it already has excellent working relationships with key industrial and commercial customers and stakeholder groups in Northern Ireland (including National Energy Action Northern Ireland, the Consumer Council for Northern Ireland (CCNI) and the Department for Regional Development (DRD)) and that it will continue these strong relationships in relation to the operation of the new licence⁴⁷⁴.

7.5.2 firmus states that throughout the development of the Ten Towns network it has proactively engaged at every opportunity with stakeholders and has always striven to promote excellent working relationships with the Authority, DETI, CCNI, DRD, Health and Safety Executive Northern Ireland (HSENI), Energy Saving Trust (EST), the Carbon Trust and NEANI⁴⁷⁵.

7.5.3 firmus outlines its proposals regarding stakeholder engagement in sections 7.2.1 and 7.4.1 of its OBP. In section 7.2.1, firmus provides a stakeholder engagement map in the form of a table (figure 7.2.1)⁴⁷⁶. The stakeholder engagement map outlines a range of stakeholder groups and organisations (statutory and otherwise) and outlines in respect of each the person within firmus who is responsible for engagement.

7.5.4 In section 7.4.1, firmus states that from the award of the licence it will commence a series of structured briefings to ensure that these stakeholder groups are kept well informed of plans and progress. Separate Key Influencer road shows will

⁴⁷⁴ firmus, *Gas to the West: Operational Business Plan*, p. 6.

⁴⁷⁵ Ibid, p. 3.

⁴⁷⁶ Ibid, p. 73.

take place in each town, 9–12 months ahead of ‘gas live’, with an extended stakeholder audience to include local head teachers, religious leaders, key business owners, local chambers. firmus states that this will ensure that all influencers in a town are kept abreast with network plans ahead of network build commencing. firmus also states that its current press office will be extended to encompass its activities under the licence to provide a contact channel for all stakeholders and that regular briefings and updates will be provided on an on-going basis⁴⁷⁷.

7.5.5 firmus states that it will undertake a series of tactical public relations campaigns to promote the specific benefits and features of natural gas on a regular basis to potential customers and help to stimulate demand from domestic households. This activity will be coordinated with its engineering, advertising and sales activity ensuring an integrated and efficient approach is maintained⁴⁷⁸.

7.5.6 In its OBP firmus also provides information in relation to the stakeholder engagement which it has already undertaken. For example, firmus has held a number of pre-meetings with stakeholders, including BGE(UK) to identify synergies between the two companies to deliver the project,⁴⁷⁹ DRD in relation to proposed works in the new area, NI Water to investigate dual trench opportunities, and NIE in relation to opportunities for joint infrastructural development and the potential for gas supply to replace existing Economy 7 domestic heating loads⁴⁸⁰.

7.5.7 In terms of its proposed engagement with other stakeholders which it has identified, firmus points to the advantages to be gained from its partnership with BGE(UK). It states that this partnership provides synergies which firmus and BGE(UK) have demonstrated over the past ten years in the construction of the Northwest pipeline, South North pipeline, steel spur lines and the connection of towns along those pipelines. Examples of such synergies include (i) the provision of a single point of contact with statutory bodies and the public, (ii) public consultations, third parties.

⁴⁷⁷ Ibid, p. 80.

⁴⁷⁸ Ibid. p.76.

⁴⁷⁹ Ibid, p. 24.

⁴⁸⁰ Ibid, p.31.

7.5.8 firmus states that both companies will engage frequently with DRD, MLA's and local councillors to keep elected representatives aware of the on-going works and any proposed disruption that may be incurred in their borough. It also states that both companies will also work closely with the Carbon Trust and ERT to promote energy efficiency and to endorse the positive contribution natural gas makes to the local carbon footprint⁴⁸¹.

7.5.9 The Authority considers that firmus has demonstrated that it has identified an appropriate range of stakeholders and has outlined proposals in respect of engagement with those stakeholders. It has also demonstrated that engagement with some stakeholders has already taken place.

Skills and experience of key members of staff and any other persons

7.5.10 In its OBP, firmus provides information in relation to the skills and experience which it has built up, as an organisation, from its current low pressure licence activities in relation to the Ten Towns. firmus has installed over 870km of mains and over 22,000 industrial and commercial and domestic services since construction began on the Ten Towns network⁴⁸².

7.5.11 firmus points to the similarity between the Ten Towns and the network to which the licence relates. It states that the Ten Towns network was developed through a similar mobilisation process to that envisaged in relation to the low pressure network and with the similarities in the two networks firmus submits that it is well placed to extend its experience from Ten Towns to the resources required for the efficient construction, operation and maintenance of the new network⁴⁸³.

7.5.12 In particular, firmus states that the senior management team in respect of the activities to be undertaken under the licence is already in place and that its existing engineering management structure will be responsible for the roll out of the network in the new licensed area⁴⁸⁴. Key personnel are named and curricula

⁴⁸¹ Ibid, p. 24.

⁴⁸² Ibid, p. 2.

⁴⁸³ Ibid, p. 3.

⁴⁸⁴ Ibid, p.10.

vitae provided⁴⁸⁵. Also, the existing Head of Sales will have overall responsibility for all connection sales activities in the new licensed area⁴⁸⁶.

7.5.13 However, given the increase in activity other staff such as engineers and sales staff need to be recruited (23 in all)⁴⁸⁷. firmus also intends to employ a consultant to work with the Commercial Development Manager in providing conversion project management to large industrial users⁴⁸⁸.

7.5.14 A contract with McNicholas Construction Services is already in place for the period 2014-2020 and firmus envisages that this contractor will be used for the construction of the new network⁴⁸⁹. The OBP states that a contract is in place with National Grid for emergency call handling service and that this will be utilised for the new licensed area.⁴⁹⁰ The OBP also states that firmus intends to put in place an arrangement to cover maintenance and emergency response in the new licensed area similar to that currently in place with SGN for the Ten Towns.

7.5.15 The Authority considers that firmus has provided detailed information which illustrates that many of the staff with the skills and experience required to undertake the activities required by the licence are already in place within the organisation and that it has extensive experience of similar activities.

7.5.16 In relation to external skills and experience, the OBP sets out a range of arrangements which are already in place with contractors with respect to key activities or which can be extended to cover the new licensed area. Although the Authority cannot directly assess either the nature of the contracts which firmus has in place, or the skills and experience of the persons with whom it has such arrangements the experience upon which firmus can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate.

⁴⁸⁵ Ibid, pp. 18 – 20.

⁴⁸⁶ Ibid, p.12.

⁴⁸⁷ Ibid, figure 2.1.2a, p.10

⁴⁸⁸ Ibid, p.3.

⁴⁸⁹ Ibid, p.15.

⁴⁹⁰ Ibid, p.15.

Management of risk

- 7.5.17 firmus sets out its risk management framework in section 4.1.2 of its OBP. This outlines how risk is identified and managed within the organisation through the use of five interrelated components, culminating in a risk radar and 'Key Risk Indicators' which are reviewed quarterly by firmus' Board⁴⁹¹.
- 7.5.18 In section 4.1.1 it sets out the key risks which it has identified with respect to the Gas to the West project. These risks include (i) external risks such as environmental risks, risks around assets, local and political non-co-operation and customers willingness to convert to natural gas, and (ii) internal risks such as health and safety risks, management distraction, financial strain and the recruitment of qualified staff. The OBP sets out strategies to mitigate each of the identified risks based on firmus' experience in relation to the Ten Towns network⁴⁹² although further detail could have been provided on the quantification of the probability and impact of the risks.
- 7.5.19 Detailed construction and operational risk management procedures are set out in section 5.7.4 of the OBP and include discussion of damage to the gas network, critical mains, defective equipment and the use of a 'Dial B4U Dig' service for contractors and individuals who intend to carry out excavation work⁴⁹³.
- 7.5.20 The Authority considers that firmus has identified, and suggested the mitigation of, a number of relevant risks associated with the activities which it would be required to undertake under the licence. It has also provided information illustrating that it has robust systems in place to deal with such risks.
- 7.5.21 This view is supported by the report from Rune⁴⁹⁴.

⁴⁹¹ Ibid, pp. 40 – 42.

⁴⁹² Ibid, pp. 36 – 39.

⁴⁹³ Ibid, pp. 53 – 54.

⁴⁹⁴ RUNE Associates, *Gas to the West; Technical Advice on Low Pressure Submissions*, 14 June 2014, p. 2.

Tendering arrangements

- 7.5.22 In its OBP, firmus sets out detailed information regarding its tendering arrangements and demonstrates an understanding of best practice in this regard.
- 7.5.23 It states that accountability for ongoing development and management of procurement processes resides with the Financial Controller and its finance function, which will draw on legal advice as required⁴⁹⁵.
- 7.5.24 Policies and procedures to ensure compliance with EU procurement regulations are described and it is stated that procurement processes have been developed to comply not only with EU Utility procurement requirements, but also with more stringent Public Sector Procurement regulations⁴⁹⁶.
- 7.5.25 Detailed information is provided in the OBP regarding the arrangements which firmus has in place for tenders both above and below the EU threshold and financial approval levels set out⁴⁹⁷. firmus states, however, that it does not anticipate a requirement for an OJEU level competition at the mobilisation phase⁴⁹⁸.
- 7.5.26 In regard to materials, firmus states that existing contract arrangements, put in place in March 2014, can be applied during the mobilisation period. It states that it would anticipate that planning for competitive tendering arrangements for materials, construction, maintenance and specialist services will re-commence in 2019 to have a new contract in place by 2020⁴⁹⁹.
- 7.5.27 In regard to construction, maintenance and specialist services, firmus states that it is proposed to award a contract for Consulting Engineers to support industrial and commercial connections in the initial phase, which is anticipated to be below the £345,000 threshold and will be tendered according to its current processes⁵⁰⁰.

⁴⁹⁵ firmus, op cit, p. 58.

⁴⁹⁶ Ibid, p. 58.

⁴⁹⁷ Ibid, pp. 59 – 62.

⁴⁹⁸ Ibid, p. 34.

⁴⁹⁹ Ibid. p. 63.

⁵⁰⁰ Ibid p. 61.

- 7.5.28 The primary essential service contract requirement is the framework contract for distribution network construction services. In section 2.2.1 of the OBP firmus states that McNicholas Construction services – contractor for period contract 2014 – 2020 in the Ten Towns network - will be responsible for providing a detailed programme of construction work and notifying all works in accordance with the NISRANS⁵⁰¹ ensuring all works are completed in accordance with all relevant legislation, recommendations and industry best practice. It notes that McNicholas has extensive experience within the natural gas industry and has been the main gas contractor in Northern Ireland since 1996⁵⁰².
- 7.5.29 Section 2.2 includes details of the proposals for procurement of the other essential services required which firmus states will be provided by extension of the contract arrangements with existing service providers. These services include activities such as emergency call handling (National Grid) and maintenance of network assets (SGN)⁵⁰³.
- 7.5.30 The Authority considers that firmus has provided detailed information regarding its proposals as to the use of tendering arrangements and that its tendering arrangements are robust, in line with best practice and proven through use in its previous projects. The Authority notes that firmus will be able to utilise a number of contracts which it already has in place in relation to materials, construction and specialist services.
- 7.5.31 This view is supported by the report from Rune⁵⁰⁴.

Final score for criterion 3.17(a)

- 7.5.32 firmus has provided a comprehensive statement, backed by appropriate evidence, of how it will undertake the activities which would be the subject of obligations set out in the licence for which it has applied.
- 7.5.33 The Authority particularly notes firmus' proposals for engagement with stakeholders, its existing relationships are very strong and the fact that some engagement has already taken place. The Authority also notes firmus' previous

⁵⁰¹ Northern Ireland Street works Registration and Notification System.

⁵⁰² Ibid, p. 15.

⁵⁰³ Ibid, pp. 15 – 16.

⁵⁰⁴ RUNE Associates, op cit, p. 6.

experience in relation to the construction and operation of low pressure networks and that where skills and experience need to be sourced externally, contracts are in place or can be extended where required. Proposals for the management of risk and tendering arrangements were also robust.

- 7.5.34 On the basis of the above the Authority confirms that its final decision is to award 16 marks out of 20 to firmus in relation to subparagraph 3.17(a) .

7.6. Specific Criteria – Operational Business Plan 3.17(b)

- 7.6.1 The Application Information Pack asked applicants to supply costs for WACC, Operating Expenditure and Mobilisation Costs and the Authority considers firmus' unconnected application submission of costs in this section. For the purposes of this paper the Authority dealt with the costs under two headings – WACC and Operating Expenditure. The Authority's views on Mobilisation costs are included under the Operating Expenditure heading. The Authority set out in the Application Information Pack⁵⁰⁵ greater detail on what these costs might include.

Weighted Average Cost of Capital

- 7.6.2 NERA was requested to produce a report on what it would expect to see in a well-evidenced WACC submission. The Authority substantially agreed with the assessment reflected in that report. It follows the Authority would have expected to see:
- a. The cost of debt set out using: (i) a benchmark gilt yield (to reflect a risk free rate) plus evidence on corporate debt spreads with market evidence provided for both; and/or (ii) direct evidence of corporate debt yields with market evidence provided. For this purpose, references to corporate debt spreads/yields should reflect companies with similar risk profiles, issuance costs should be included in the cost of debt and the treatment of inflation should be clearly explained in the derivation.
 - b. The cost of equity set out using CAPM and incorporating the risk free rate,

⁵⁰⁵ Applicant Information Pack Annex 8

equity risk premium and beta with relevant evidence provided to justify each component.

- c. The proposed gearing including a discussion on the how this interacts with the risks of the project, the proposed credit rating and the cost of debt.
- 7.6.3 The application is based on a standard debt / equity capital structure and includes proposals for both debt and equity costs applying the CAPM model to propose a WACC range of 5.47-7.73% and a final figure of 5.57%.⁵⁰⁶
- 7.6.4 The Authority considers that the application provides reasonable detail and evidence as to how the final figure in the Data Input Workbook was arrived at.
- 7.6.5 On the cost of debt firmus set out two approaches which are used to calculate an upper and lower bound. The lower bound estimates a risk free rate and adds a corporate debt premium while the upper bound uses a 10 year average of an index of corporate debt setting out clearly which index is used and its reasons.
- 7.6.6 There is a reasonable discussion of some elements of the WACC such as the risk free rate and cost of debt although it is limited.⁵⁰⁷ There is some good evidence provided such as equity market returns and risk premium.⁵⁰⁸ The evidence is what would be expected in reviewing regulatory WACCs and the Authority views the evidence as robust.
- 7.6.7 There is a good discussion of issues around volume risk and the application includes some evidence of an effort to calculate the impact of volume risk using the CAPM model.⁵⁰⁹ Similarly there is a good discussion on construction risk⁵¹⁰ and how this might impact on asset betas.
- 7.6.8 There are gaps in the explanation provided. For example there is no final table setting out the values for individual components of the WACC and how they interact to arrive at a final figure. There is a significant gap between the upper

⁵⁰⁶ firmus Connected OBP, p92

⁵⁰⁷ firmus Connected OBP, p92

⁵⁰⁸ firmus Connected OBP, p92

⁵⁰⁹ firmus Connected OBP, p93, footnote 16

⁵¹⁰ firmus Connected OBP, p94

and lower bounds presented and the reasons given for the final figure⁵¹¹ do not reference the CAPM model.

- 7.6.9 There is limited description or evidence provided as to how the final values for key WACC components were arrived at. For example there is no clarity on what level of gearing is used.⁵¹²
- 7.6.10 In addition while the discussion on volume risk is good it is not clear what figure is actually used as part of the final WACC.

Operating Expenditure

- 7.6.11 Mobilisation costs were clearly and concisely explained in both the OBP⁵¹³ and in the appended Excel workbook⁵¹⁴. There are some figures e.g. buildings, which have limited explanation and are hard coded into the spreadsheet. However the largest cost line is manpower which makes up over 70% of mobilisation costs and this is explained in a comprehensive manner in both the OBP⁵¹⁵ and the spreadsheet⁵¹⁶.
- 7.6.12 Operating Expenditure is clearly and concisely explained in both the OBP⁵¹⁷ and in the appended Excel workbook⁵¹⁸. The largest element is manpower costs which make up about one half of controllable operating expenditure costs over the ten years and it is comprehensively explained in terms of manpower numbers⁵¹⁹ and manpower costs with the spreadsheet⁵²⁰ providing greater detail on how the calculations are performed to reach the final figure.
- 7.6.13 The Authority notes that while there is a useful discussion of some other costs e.g. Marketing Development, Advertising and PR⁵²¹, the final figure is not well explained.

⁵¹¹ firmus Connected OBP, p91

⁵¹² firmus Connected OBP, p93

⁵¹³ Operational Business Plan firmus Energy May 2014-Section 3.4

⁵¹⁴ Mobilisation and supporting Schedules and Detailed Workings

⁵¹⁵ firmus Connected OBP, p17, 24, 26, 27

⁵¹⁶ Mobilisation and supporting Schedules and Detailed Workings

⁵¹⁷ Operational Business Plan firmus Energy May 2014-Section 8.3

⁵¹⁸ Schedules and Detailed Workings

⁵¹⁹ firmus Connected OBP, p17

⁵²⁰ Supporting Schedules and Detailed Workings, Manpower Summary sheet

⁵²¹ firmus Connected OBP, p79

- 7.6.14 The Authority also noted that the figure for Miscellaneous items is quite substantial at over 15% of controllable operating costs in years one to ten but the explanation for the costs included is limited.

Identification and application of cost drivers

Operating Expenditure

- 7.6.15 Mobilisation - Cost drivers are clearly aligned with those used to forecast Operating Expenditure and applied on a constant basis across the OBP and the Data Input Workbook.⁵²² The spreadsheet⁵²³ also sets out clearly how cost drivers lead to final proposed costs. The Authority does note that using employee headcount as a driver for professional and legal fees is not likely to be robust.
- 7.6.16 Operating Expenditure - Cost drivers are clearly stated, are based on direct Northern Ireland experience e.g. GD14 determination and applied on a constant basis across the OBP and the Data Input Workbook.⁵²⁴ The Authority notes that some costs are hard coded into the Spreadsheet e.g. market development and advertising⁵²⁵. This makes understanding the cost drivers more difficult.

Robustness of assumptions

- 7.6.17 The Authority identified and considered a number of assumptions that appeared to have been made by firmus when deriving the data contained in its Data Input Workbook.

The Value of the WACC

- 7.6.18 First, the Authority took it to be implicit throughout the application that firmus had assumed it will be able to carry on the licensed activities under the low pressure licence, and to do so consistently with its obligations under that licence, on the basis of the proposed WACC. That is to say, there was an implicit assumption that firmus will be able to raise the finance required to construct and operate the

⁵²² Applicant Information Pack - Annex 8

⁵²³ Mobilisation and supporting Schedules and Detailed Workings

⁵²⁴ Applicant Information Pack - Annex 8

⁵²⁵ Supporting Schedules and Detailed Workings, M,A&PR sheet

low pressure network while subject to a revenue control condition embodying its proposed WACC.

- 7.6.19 For the purpose of testing this assumption, the Authority considered whether the proposed WACC fell within the range of what might reasonably be expected in the context of the G2W project. To do this, it considered the market cost of debt and equity based on advice received from NERA, which took into account in its report such costs as referenced in recent regulatory decisions⁵²⁶. NERA advised on what it considered to be the 'plausible range' within which it would expect any WACC for this project to lie. The Authority relied upon the advice contained in the report as establishing a range against which to test firmus's assumption
- 7.6.20 NERA established a 'plausible range' in respect of a corporate finance structure of between 3.5% and 6.2%. firmus' proposed WACC was 5.47%.
- 7.6.21 The Authority noted that the proposed firmus WACC lay at the high end of, but fell within, the range identified by NERA.
- 7.6.22 In addition firmus identified its ability and intention to finance the project through corporate finance from its parent BGE, and referenced the parents financial statements and its access to finance facilities⁵²⁷. It stated that it had already received the approval of its Board of Directors, so that financial resources were available to complete the project⁵²⁸. In addition it provided historical evidence that it had raised finance for construction of low pressure pipelines in Northern Ireland⁵²⁹. firmus also highlighted that if the proposed purchase of firmus by ICON concluded on 30 June 2014, as anticipated, firmus would no longer have access to finance from the BGE parent company. In this instance firmus referenced letters of comfort from a number of financial institutions, Royal Bank of Scotland and Lloyds⁵³⁰ and the history of ICON in raising finance to purchase regulated network utilities⁵³¹.

⁵²⁶ NERA, Gas to the West, A report for the Utility Regulator

⁵²⁷ firmus Responses to Email from Utility Regulator, 9th May 2014

⁵²⁸ Ibid

⁵²⁹ Ibid

⁵³⁰ Appendix 1 Independent Application – ICON Ownership

⁵³¹ Ibid

- 7.6.23 The Authority considered that these letters of comfort did not represent a firm commitment by the relevant banks to provide the required financing. The letters note that any future funding commitment would be conditional on several factors, including credit market conditions, satisfactory due diligence, the final form of the legal documents and the licence, and other factors. They are not legally binding, nor do they purport to be so. Moreover, the Authority did not understand them to commit the banks in any sense that might properly be regarded (even allowing that they fall short of a legal obligation) as entailing a 'firm' commitment.
- 7.6.24 In order to clarify whether its understanding of the status and effect of the comfort letters was correct, the Authority sought advice from both NERA⁵³² and the Strategic Investment Board⁵³³. Each of them confirmed the Authority's initial view that there was significant conditionality attached to the letters, including in relation to due diligence and internal bank clearances. The Strategic Investment Board noted that while the letters 'certainly indicate willingness from the funders concerned to participate in the project', it did 'not believe that the letters can be relied upon as evidence'. The Authority accepted this advice.
- 7.6.25 This did not entail any conclusion that the letters of comfort were inappropriate. The Authority recognised that funding commitments are likely to be contingent on, and related to the conditions of, the licence as granted; in particular on the terms of the price control which determine the value of the income stream that can be generated by the licence holder.
- 7.6.26 Moreover, the Authority did not consider that there was any ground for materially distinguishing between the weightings applied to applicants. It accepted the advice of the Strategic Investment Board in this respect.
- 7.6.27 However, while accepting that a comfort letter indicates a willingness on the part of the relevant funder to participate in the project, the Authority considers that no material degree of weight can be attached to such letters for the purposes of demonstrating firmus' cost of debt.
- 7.6.28 Given the proposed purchase of firmus by ICON the Authority put less weight on the proposal for BGE to finance the project through corporate finance.

⁵³² NERA, Gas to the West, A report for the Utility Regulator p.21.

⁵³³ SIB – Letter to Uregni (2).

7.6.29 Having regard to its own expertise, the Authority considered that the proposed WACC was high and therefore reflective of a cost of debt and equity that would attract investors. Given that the WACC also lay within NERA's plausible range, and given the historical evidence presented, the Authority had no concerns about the ability of firmus to finance its activities under the low pressure licence on the basis of the proposed WACC.

7.6.30 Therefore the Authority concluded that the assumption that firmus would be able to obtain financing to carry on the licensed activities on the basis of the proposed WACC was robust.

Asset Beta

7.6.31 The discussions on construction risk suggest that it would be appropriate to compare this pipeline with PFI projects or Terminal 5 at Heathrow. The reasons why this would be the case are not well evidenced and the Authority does not find the assumption robust. However the Authority does note that such risks appear not to have been included in the final WACC.

7.6.32 There is a request in the discussion on volume risk that the return to be applied to under recoveries is the full WACC⁵³⁴. This is inconsistent with the return which was clearly set out in the application pack⁵³⁵. To the extent that firmus' application is premised on an assumed higher rate of return to be applied to under recoveries, that assumption is not robust.

Operating Expenditure

7.6.33 Operating Expenditure - Assumptions are clearly stated and applied on a consistent basis and are based on reliable evidence from the GD14 price control determination e.g. manpower costs.

Evidence verifiable from previous experience

7.6.34 Northern Ireland specific experience has been drawn upon in the identification and application of cost drivers when forecasting future Operating Expenditure

⁵³⁴ firmus Connected OBP, p93.

⁵³⁵ Applicant Information Pack, paragraph 3.56 & 3.57.

levels. There is a particular application of GD14 determined allowances e.g. manpower costs⁵³⁶ and this provides for robust figures.

- 7.6.35 The Authority notes that when estimating the cost of debt the application uses a trailing average over a ten year period. While this is reasonable it would have been an improvement to consider how this interacts with current market evidence.⁵³⁷

Identification and quantification of risk

Operating Expenditure

- 7.6.36 There is a limited discussion of risks⁵³⁸, including identification of some risk factors and a discussion about possible mitigating factors.
- 7.6.37 The Authority views that the identification of risk is limited. The Authority would have expected some underlying risks which might impact on costs to be identified.
- 7.6.38 The Authority notes that there is no quantification of the probability of a risk occurring nor is there any quantification of the impact on outputs. This appears to be inconsistent with the companies stated approach to risk which includes the quantification of the impact of the risk and the likelihood of the event occurring⁵³⁹.
- 7.6.39 Therefore the Authority concludes that while there has been a reasonable identification of some risks there is no evidence that they have been quantified.

Efficiency improvement plan

- 7.6.40 The efficiency improvement plan⁵⁴⁰ covers efficiencies included in the proposed costs because of economies of scale as well as referencing the ITT section as providing cost efficiencies.

⁵³⁶ firmus Connected OBP, p27.

⁵³⁷ Applicant Information Pack Annex 8 Low Pressure Workbook Notes.

⁵³⁸ firmus Connected OBP, p82

⁵³⁹ firmus Connected OBP, p37

⁵⁴⁰ firmus Connected OBP, p84

- 7.6.41 The plan also mentions the contribution of smart meters, computer tablets and benchmarking as contributing towards efficiency.
- 7.6.42 The evidence provided in this application lacks any quantification of the benefits. For example there is no analysis of how the benefits of smart meters would outweigh the costs.
- 7.6.43 The Authority also does not think the argument that benefits from scale economies, which are already built into the cost forecasts constitutes an efficiency improvement plan.
- 7.6.44 While the use of benchmarking⁵⁴¹ is a good example of how cost improvement can be driven overall the Authority finds the application lacks evidence of a strong efficiency improvement plan delivering quantified benefits.

Final score for criterion 3.17(b)

Weighted Average Cost of Capital

- 7.6.45 The evidence presented in this application in support of the WACC was reasonably well evidenced but gaps in the explanation were identified.
- 7.6.46 Overall the Authority finds that in relation to the Weighted Average Cost of Capital the application to be of moderate quality when judged against sub criterion 3.17b. Although the Authority recognises that both the methods and evidence used to estimate the value of the various WACC components are robust the application fails to set out in sufficient detail how final values were arrived at and how these in combination resulted in the derivation of the WACC figure in the Data Input Workbook.

Operating Expenditure

- 7.6.47 Overall the build up of mobilisation and operating costs was very well evidenced although the analysis of risk and the efficiency improvement plan were of a much lower standard. Overall this part of the submission could be described as high to moderate.

⁵⁴¹ firmus Connected OBP, p85-86

Final conclusion

- 7.6.48 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the firmus application should attract a medium score, and its final decision is to award 14 out of 20 marks.
- 7.6.49 The Authority compared this mark with those awarded to the other low pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.
- 7.6.50 When compared with the other applications, the Authority considered that the firmus application was better than the others in relation to Operating Expenditure in that a spreadsheet had been included and no errors were identified although more detail could have been provided in some areas. On the other hand the submission in relation to WACC fell between the other two submissions in that the derivation of WACC was not fully explained and not as comprehensive as SGN. However it was substantially better evidenced than the PNGL submission.

7.7. Specific Criteria – Operational Business Plan 3.17(c)

The experience of the applicant and others on whom it intends to rely in relation to network construction

- 7.7.1 As discussed above, firmus has installed over 870km of gas mains and over 22,000 services throughout within its existing licensed area⁵⁴². The construction team within firmus has been responsible for designing the network roll out as well as associated customer installations for both domestic and large industrial and commercial customers.⁵⁴³
- 7.7.2 firmus points to the similarity between the its existing Ten Towns network and the network to which the licence relates and states that its existing network was developed through a similar mobilisation process to that envisaged in relation to the new network. Given the similarities in the two networks firmus submits that it is well placed to extend its existing experience to the resources required for the

⁵⁴² Ibid, p.10 and section 3.6.

⁵⁴³ Ibid, p. 11.

efficient construction and operation of the new network⁵⁴⁴. The Authority places weight on firmus' recent experience in constructing low pressure pipelines in Northern Ireland.

7.7.3 As well as experience at corporate level, firmus also provides details of the skills and experience of the senior management team which will oversee the initial phase of activity under the licence until a management team in Northern Ireland is recruited⁵⁴⁵.

7.7.4 In relation to external skills and experience, firmus has a contract in place with McNicholas Construction Services covering the period 2014-2020 and firmus envisages that the construction of the new network will take place under this contract⁵⁴⁶. McNicholas has constructed the existing firmus network in the Ten Towns area⁵⁴⁷. However, firmus has also indicated that it would be happy to discuss tendering for Mains and Service laying services if deemed appropriate⁵⁴⁸. The Authority places weight on the fact that firmus has a current contract in place with McNicholas

7.7.5 Although the Authority cannot directly assess either the nature of the contract which firmus has in place with McNicholas, the experience upon which firmus can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate. The Authority also places weight on the fact that NcNicholas has experience of constructing low pressure networks in Northern Ireland.

7.7.6 The Authority considers that firmus has demonstrated that in relation to the construction of the network it has appropriate skills and experience both within the company and in the contractor for the construction on whom it will rely.

7.7.7 This view is supported by the report from Rune⁵⁴⁹.

⁵⁴⁴ Ibid, p. 3.

⁵⁴⁵ Ibid, pp. 18 – 20.

⁵⁴⁶ Ibid, p. 15.

⁵⁴⁷ Ibid, p. 11.

⁵⁴⁸ Ibid, p. 24.

⁵⁴⁹ RUNE Associates, op cit, p. 10.

The experience of the applicant and others on whom it intends to rely in relation to network operation

- 7.7.8 firmus currently operates the low pressure network in its existing licensed area and has done so since 2005⁵⁵⁰. It has an asset management system in place⁵⁵¹, and a Transportation Services Team which manages the network code and is responsible for, among other things, customer switching and the allocation of gas flows to suppliers⁵⁵².
- 7.7.9 firmus states that it has developed procedures and processes to monitor its existing network and to respond effectively to incidents to both ensure the safety of the general public and its personnel, and maintain security of supply⁵⁵³. Section 5.7 of the OBP describes asset management processes and section 5.7.1 indicates that firmus operates a system of annual inspection on all of its sites which fall under the governance of the PSSR: 2000. It also carries out function checks on safety devices and condition assessments of all equipment installed at these sites at the same visit⁵⁵⁴.
- 7.7.10 In relation to external skills and experience, firmus relies on BGE for system control arrangements in place for its existing network. firmus utilises Technolog's PMAC⁵⁵⁵ system to monitor the distribution system at key locations within each town with alarms sent to the Bord Gais Network control centre in Finglas⁵⁵⁶. However, it is not clear from the OBP whether this service from Bord Gais will continue once ownership of firmus is transferred to iCon.
- 7.7.11 firmus also indicates that contracts are in place with SGN for maintenance and emergency response on the network and with National Grid to handle emergency calls from the public to the Northern Ireland Emergency Gas Number⁵⁵⁷. The OBP indicates that the contract with National Grid will cover the new licensed area⁵⁵⁸. However, it is not clear if the current contract with SGN will

⁵⁵⁰ firmus, op cit, section 1.3 and chapter 5.

⁵⁵¹ Ibid, section 5.6 and 5.7.

⁵⁵² Ibid, p. 48.

⁵⁵³ Ibid, p. 3.

⁵⁵⁴ Ibid, p. 52.

⁵⁵⁵ Pressure Monitoring and Control.

⁵⁵⁶ Ibid, p. 49.

⁵⁵⁷ Ibid, p. 15 and section 5.8.

⁵⁵⁸ Ibid, p.15.

be extended to the new licensed area as firmus merely states that ‘a similar arrangement will be put in place for Gas to the West’⁵⁵⁹.

7.7.12 The Authority considers that firmus has demonstrated that in relation to the operation of the network it has appropriate skills and experience within the company based on its experience in operating a similar network in Northern Ireland.

7.7.13 This view is supported by the report from Rune⁵⁶⁰.

Securing, mobilisation and management of resources

7.7.14 As stated above, firmus indicates that it envisages a similar mobilisation process to that used for its existing network. firmus states that through its existing business, it already has internal operating teams, processes and procedures, external agencies, contractors, stakeholder relations and a governance structure in place⁵⁶¹.

7.7.15 In relation to the mobilisation of internal resources necessary to construct a low pressure network, firmus states that the current senior management team will manage the business in the new licensed area with the Head of Engineering having overall control of the mobilisation project⁵⁶². Also, additional internal resources will be deployed from each of the functional areas of expertise such as engineering and sales and marketing⁵⁶³.

7.7.16 Any increase in personnel will be at the lower levels of the organisation structure and figure 2.2.3 provides a detailed summary of the additional manpower roles which are required, categorised by department, role, pay band and date⁵⁶⁴.

7.7.17 firmus states that it has the relevant information systems in place (such as felive, GIS and Oracle⁵⁶⁵) to provide management information required to manage the new distribution network.⁵⁶⁶

⁵⁵⁹ Ibid.

⁵⁶⁰ RUNE Associates, op cit, p. 12.

⁵⁶¹ firmus, op cit, p. 9.

⁵⁶² Ibid, p. 24.

⁵⁶³ Ibid, p. 26.

⁵⁶⁴ Ibid, p. 17.

- 7.7.18 In relation to the mobilisation of external resources the OBP indicates that a number of contracts are already in place. As noted above, the contract with McNicholas for construction is already in place and can be used for the new licensed area. A contract is also in place with GL Noble Denton to provide services in order to ensure compliance with the requirements of the Pressure Systems Safety Regulations and firmus state that services will be provided by a senior engineer from GL Noble Denton who will visit firmus energy every three months to sign off the pressure systems in the new licensed area⁵⁶⁷.
- 7.7.19 In addition, firmus states that an industrial engineering consultant will be employed to work closely with the Commercial Development Manager (CDM) for the purpose of accelerating industrial connections to the network and to project manage industrial customers through the conversion process. The consultant has not been identified although firmus states that this resource will be recruited via an industry recognised employment agency such as Wilcock Consulting⁵⁶⁸.
- 7.7.20 The Authority considers that firmus has provided detailed proposals on securing, mobilisation of, and management of, the internal and external resources necessary to construct the low pressure network. The Authority particularly notes firmus' previous experience in this regard in Northern Ireland.
- 7.7.21 This view is supported by the report from Rune⁵⁶⁹.

The experience of the applicant and others on whom it intends to rely in relation to achieving connections

- 7.7.22 firmus indicates that it has a strong track record of achieving connections in its existing licensed area which was not previously supplied with gas. firmus states that it has connected 4,250 customers per annum, with 22,000 customers connected overall⁵⁷⁰.

⁵⁶⁵ Felive facilitates project costing and management, transportation services, site works and sundry service billing. GIS facilitates network mapping and asset management while ORACLE supports procurement, accounts, and financial reporting.

⁵⁶⁶ firmus, op cit, p.31.

⁵⁶⁷ Ibid, pp. 15 – 16.

⁵⁶⁸ Ibid, pp. 3 and 22.

⁵⁶⁹ RUNE Associates, pp.16 and 21.

⁵⁷⁰ firmus, op cit, p. 1.

- 7.7.23 As the Authority would expect, firmus recognises that the development of a network of installer and retailers is crucial to future connection growth. In particular, firmus points to its experience in its existing licensed area of developing a network of local installers and associated trades, including natural gas retailers, manufacturers, plumbing suppliers and trade publications. firmus states that over 50 installers are currently registered with it and that all of these installers are Gas Safe registered⁵⁷¹.
- 7.7.24 firmus also points to other customer and stakeholder relationships that it has developed as part of the process of generating connections in its existing licensed area. Such stakeholders include local councils and road authorities⁵⁷² and the majority of the 20 largest industrial users identified in the Fingleton McAdam design⁵⁷³.
- 7.7.25 The Authority notes that firmus has assessed the opportunity for connections both in total and by town in the new licensed area. In particular, firmus has provided a table of the number of 'addressable properties' in each town⁵⁷⁴ and states that it has profiled the demographic make-up of the new area using its experience in the Ten Towns network to create a marketing and sales plan to deliver the connection targets⁵⁷⁵.
- 7.7.26 As part of its proposals to achieve connections, firmus states that it plans to extend its local installer network to the new licensed area⁵⁷⁶. It also emphasises that it also has a close working relationship with Gas Safe⁵⁷⁷.
- 7.7.27 firmus states that it intends to employ a consultant to work with its Commercial Development Manager in providing conversion project management to large industrial users. However, as discussed above, that person has not yet been recruited.
- 7.7.28 The firmus submission also makes reference to the importance of the existing firmus brand. The Authority notes that, in regard to connections, firmus is the

⁵⁷¹ Ibid, p. 72.

⁵⁷² Ibid, p. 7.

⁵⁷³ Ibid, p. 7.

⁵⁷⁴ Ibid, figure 7.1.1e, p. 64.

⁵⁷⁵ Ibid, p. 64.

⁵⁷⁶ Ibid, p. 72.

⁵⁷⁷ Ibid, p. 15.

only applicant for the low pressure licence to note that ‘synergies could be derived in rolling out uniform natural gas brand messaging for Northern Ireland’⁵⁷⁸. This is consistent with the proposed licence condition set out in the Applicant Information Pack.⁵⁷⁹

- 7.7.29 The Authority considers that firmus has provided detailed information in relation to its experience of achieving connections in an area not previously supplied with gas through a gas network and, drawing on that experience, has made relevant proposals in relation to the new licensed area.

Developing relationships with business and social landlords

- 7.7.30 firmus affirms the importance of developing the relationships necessary to drive connections and sets out its experience and existing relationships in its current licensed area. firmus states that it is leveraging existing relationships within its existing Ten Towns network and the Greater Belfast network to talk to large commercial customers about load information surveys, and that meetings are being conducted with other large potential users⁵⁸⁰.
- 7.7.31 In its existing licensed area, firmus uses energy advisors to manage relationships with businesses and a Commercial Development Manager to manage its relationships with large customers. In its OBP, firmus indicates that it will replicate this approach in the new licensed area.
- 7.7.32 firmus points to the fact that every large potential contract site in each town has been surveyed by their Commercial Development Manager and a database has been compiled outlining contact details, existing fuel usage/cost, existing plant, likelihood to convert/cost, proposed future energy requirements and potential utilisation of new and more efficient technologies (such as Combined Heat and Power)⁵⁸¹. firmus states that it already has existing relationships with potential business customers in the new licensed area such as Dale Farm, Moy Park,

⁵⁷⁸ Ibid, p. 88.

⁵⁷⁹ Applicant Information Pack paragraph 3.68.

⁵⁸⁰ Ibid, p. 31.

⁵⁸¹ Ibid, p. 72.

Kerry Foods, Linden Foods, WHSCT, NHSCT and Education and Library Boards⁵⁸².

7.7.33 In addition, firmus also points to the fact that it has previously worked with NIHE appointed contractors and NIHE Regional planners in the west of Northern Ireland (H&A Mechanical and BC Energy)⁵⁸³.

7.7.34 firmus states that it has met with NIHE district planners and has obtained details of its future Heating Replacement Programme in the new licensed area⁵⁸⁴.

7.7.35 The Authority considers that firmus has provided detailed information in regard to its existing relationships with businesses and NIHE and its proposals to build on these relationships to maximise the number of premises connecting to the new network.

Connections to vulnerable customers

7.7.36 firmus puts forward information in regard to vulnerable customers in section 7.2.3 of its OBP. It states that it has engaged in several partnerships with Bryson Energy, including a 'Winter Warmth Scheme' which helps most vulnerable customers improve energy efficiency in their homes. This free service was designed for customers in firmus' network area outside of greater Belfast who were more than 60 years old and either living alone or with a minor, and who have a disability or are chronically ill. The scheme offered a home visit from a professionally trained Bryson Energy representative who reviewed the customer's energy bills, ensured that they were fully aware of how to get the best use from their natural gas heating system and referred those who were eligible to any suitable energy efficiency schemes⁵⁸⁵.

7.7.37 firmus states that a similar initiative is currently on-going and that it intends to replicate this initiative in the new licensed area.

7.7.38 firmus states that its energy advisors also actively source referrals and promote the Warm Homes Scheme introduced by the DSD to tackle fuel poverty. The

⁵⁸² Ibid.

⁵⁸³ Ibid, p. 75.

⁵⁸⁴ Ibid, p. 75.

⁵⁸⁵ Ibid, p. 76.

scheme provides a package of free energy efficiency and heating measures to residential home-owners and those who rent from private landlords on a qualifying benefit.

7.7.39 firmus also points to the fact that it has secured £1.2million of Northern Ireland Sustainable Energy Project (NISEP) funding, which will be utilised to assist vulnerable customers in paying for conversion from solid fuel/electricity or solid fuel heating to natural gas heating.⁵⁸⁶

7.7.40 However, the OBP does not quantify firmus' success in connecting vulnerable customers as a consequence of these measures.

7.7.41 The OBP lists a number of other measures that firmus currently apply in the Ten Towns area and states that these will be extended to vulnerable customers in the new licensed area. These measures include the use of prepayment meters, working with Gas Safe to promote the installation of high efficiency Sedbuk 'A' rated boilers, and the firmus care scheme⁵⁸⁷.

7.7.42 The Authority notes that while all of the measures which firmus describes will assist vulnerable customers once connected, the application does not explain clearly how some of these measures will assist in actually promoting connections to these customers as required by paragraph 3.20(b)(iv) of the Criteria.

Final score for criterion 3.17(c)

7.7.43 The Authority considers that firmus has provided detailed information in respect of most of the elements of subparagraph 3.20(b) of the Criteria. The information which it has provided in relation to subparagraph 3.20(b)(iv) is not strictly relevant to the requirements of that subparagraph, however.

7.7.44 The Authority particularly notes firmus' experience of network construction and operation and its proposals for mobilisation based on its experience in its existing licensed area. Proposals for connections were also well evidenced and the Authority notes in particular that firmus has existing relationships with local installers, businesses, and other stakeholders and has recognised the

⁵⁸⁶ firmus Connected OBP, p.3.

⁵⁸⁷ firmus Connected OBP, pp.74-75.

importance of a uniform natural gas brand. firmus has also provided a table of the number of 'addressable properties' in each town⁵⁸⁸ and has profiled the demographic make-up of the new area.

- 7.7.45 On the basis of the above the Authority confirms that its final decision is to award 16 marks out of 20 to firmus' application in relation to paragraph 3.17(c).

7.8. Specific Criteria – Innovation & Technology

- 7.8.1 firmus has sought to address innovation and technology transfer in a standalone document (the ITT) submitted as part of its application which considers the matters listed in paragraph 3.21 of the Criteria systematically.

Environmental sustainability

- 7.8.2 In relation to measures to ensure sustainability with respect to the environment, firmus points to a number of no-dig technologies with benefits in terms of environmental sustainability such as trenchless gas mainlaying and tensile loading. firmus also states that it will consider building upon Bord Gais Networks' experience to provide a site within the new licensed area for a compressed natural gas (CNG) station to initially fuel both firmus vehicles and those of its customers⁵⁸⁹.
- 7.8.3 firmus also provides some discussion of measures to reduce the impact of its business on the environment, such as pointing to the fact that it has attained the CORE corporate responsibility standard from Business in the Community Northern Ireland. It also lists a number of measures that it will undertake in the new licensed area such as Carbon Trust audits, examining opportunities to work with other utilities (such as NIE and NI Water) on dual trenching and reinstatement activities, and having a policy which ensures that it sends zero recyclable waste to landfill⁵⁹⁰.

⁵⁸⁸ firmus Connected OBP, figure 7.1.1e, p.64.

⁵⁸⁹ firmus, Gas to the West: Innovation and Technology Transfer, p. 5.

⁵⁹⁰ Ibid, p. 7

Efficiency in gas and new sources of gas

- 7.8.4 There are a number of proposals for efficiency in the use of gas under the heading of distribution network innovation, e.g. remote pressure regulation and district pressure monitoring. However, firmus has not demonstrated clearly how these examples promote efficiency in the use of gas.
- 7.8.5 As stated above in 2.9.1 where the applicant is applying for a low pressure licence the Authority would expect to see evidence of innovative technologies to reduce customer's consumption of gas. In this respect firmus proposes the use of Climote⁵⁹¹ in suitable homes in the new licensed area⁵⁹². firmus also states that it has identified a number of customers in the new licensed area who could benefit from decentralised heating and installation of Combined Heat and Power. It states that it has identified three opportunities for decentralised heating and ten loads which are potentially suitable for medium/large scale Combined Heat and Power installations.⁵⁹³

Cost efficiency

- 7.8.6 In relation to cost efficiency, firmus points to specific engineering projects and identifies cost savings for some of them, such as AGI positioning⁵⁹⁴.
- 7.8.7 firmus also references stakeholder engagement as a means to achieve cost efficiency but has not demonstrated how this contributes to cost efficiency⁵⁹⁵.
- 7.8.8 Development of the network to more remote geographical areas
- 7.8.9 The development of the gas network is dealt with in section 11.4 of the ITT. This predominantly highlights successes in developing the existing network as evidence for how firmus would develop the new licensed area⁵⁹⁶. However, this explanation is not tailored to innovation in relation to the development of the network to more remote geographical areas.

⁵⁹¹ Climote is a smart energy controller which allows domestic customers to control their heating from any computer or enabled smart device.

⁵⁹² firmus, ITT, section 11.1.

⁵⁹³ Ibid, p. 8.

⁵⁹⁴ Ibid, p. 12-13.

⁵⁹⁵ Ibid, p. 11.

⁵⁹⁶ Ibid, p. 14 – 15.

History of innovation

- 7.8.10 firmus cites a number of examples of previous innovation in section 11.5, including its work related to the Craigavon Bridge, fitting of excess flow valves, and the use of off-site construction methods.
- 7.8.11 The Authority considers that these examples may be directly relevant to the network in the new area and illustrate an ability to innovate more generally.
- 7.8.12 This view is supported by the report from Rune⁵⁹⁷.

Ability to secure funding

- 7.8.13 firmus points to the fact it has a dedicated Energy Advisor who specialises in managing government and regulatory Authority funding⁵⁹⁸.
- 7.8.14 In addition, firmus states that it has secured funding from a number of different sources. In particular firmus points to the fact that it is the only gas distribution network operator to avail of NISEP⁵⁹⁹ and has secured £1.2m worth of funding for 2014/15 and similar funding in 2013/14. firmus expect that this type of funding will be important in supporting residential connections in the new licensed area⁶⁰⁰. firmus also points to the fact that it has worked with the Energy Saving Trust (EST) to gain a NISEP grant of £60,000 towards the costs of installing a gas-fired combined heat and power unit to supply electricity and hot water to the main Daisy Hill Hospital Building in Newry⁶⁰¹.
- 7.8.15 firmus points to the boiler replacement allowance funded by the NI Executive and the Warm Homes Scheme funded by DSD but it is not clear, particularly in relation to the latter, that firmus has secured funding or whether they are assisting their customers in this regard.⁶⁰²
- 7.8.16 The Authority considers that firmus has provided some evidence of its ability to secure funding. However, the examples provided have not been of funding to support innovation. This view is supported by the report from Rune which also

⁵⁹⁷ RUNE Associates, op cit, p. 24.

⁵⁹⁸ firmus, ITT, section 11.6.

⁵⁹⁹ Ibid, p. 20.

⁶⁰⁰ Ibid, p. 21.

⁶⁰¹ Ibid.

⁶⁰² Ibid.

concludes that 'there is no direct evidence of securing funding for innovative developments.

7.8.17 In relation to staff development, firmus states that it has received £20,000 funding from Energy & Utility Skills (EUS) for energy efficiency and skills development training for its staff⁶⁰³.

7.8.18 The Authority considers that firmus has provided some evidence of its ability to secure funding. However, the examples provided have not been of funding to support innovation. This view is supported by the report from Rune which also concludes that 'there is no direct evidence of securing funding for innovative developments.⁶⁰⁴

Transfer of innovation into Northern Ireland

7.8.19 The Authority notes that firmus is in initial discussions with the Mountaineer Gas Company (MGC)⁶⁰⁵ to understand the latter's operations and whether it can transfer any innovations into the firmus business. However, the ITT does not reference any specific examples that firmus proposes to transfer to the new licensed area⁶⁰⁶.

7.8.20 As noted above, the submission also indicates that firmus will look to build upon Bord Gais Networks' experience of supporting a CNG infrastructure for its vehicles and those of its customers⁶⁰⁷.

7.8.21 The Authority considers that firmus has therefore provided limited proposals to transfer innovation into Northern Ireland.

7.8.22 This view is supported by the report from Rune which concludes that there is 'little by way of specific proposals to apply further innovative approaches to the G2W project'⁶⁰⁸.

Existing skills and experience

⁶⁰³ Ibid, p.22.

⁶⁰⁴ RUNE Associates, op cit, p. 24.

⁶⁰⁵ firmus states that MGC serves over 220,000 customers and is the largest natural gas distribution company in West Virginia with around 5,600 miles of natural gas distribution pipeline. firmus ITT, p.22.

⁶⁰⁶ firmus, ITT, p. 22

⁶⁰⁷ Ibid, pp. 5-6.

⁶⁰⁸ RUNE Associates, op cit, p.24.

- 7.8.23 firmus does not detail the existing skills and experience of its staff in relation to innovation. Instead, the application references firmus' competency management framework generally and refers back to section 2.3.2 of the OBP⁶⁰⁹. That section sets out the qualifications and experience of key staff but does not specifically consider innovation and technology transfer in this regard.
- 7.8.24 There is reference to a skills transfer programme with the aim of ensuring all existing skills are optimised in the new licensed area, but again this is not tailored to innovation⁶¹⁰.
- 7.8.25 As stated in paragraph 2.x.x above, the Authority considers there to be some overlap between this subparagraph 3.21(b)(iv) of the Criteria and subparagraph 3.21(b)(i) as evidence of a history of innovation is one way in which skills and experience may be demonstrated. firmus has therefore been given some credit with respect to subparagraph 3.21(b)(iv) on the basis of the examples of previous innovation described in section 11.5 of its ITT.

Final score for the ITT criteria

- 7.8.26 The evidential burden is on the applicant to provide the Authority with information on which to base its assessment under paragraph 3.21 of the Criteria.
- 7.8.27 In respect of the matters listed in paragraph 3.21(a), firmus has provided evidence in relation to its ability to achieve innovation and technology transfer in relation to environmental sustainability and efficiency in the use of gas. However, the Authority would have expected to see more quantification of savings from past innovations, and a proposal, tailored to innovation, for the development of the network to more remote geographical areas.
- 7.8.28 In respect of the matters listed in 3.21(b) firmus has provided a number of examples of past innovation and has also demonstrated an ability to secure funding. However, the examples given for firmus' ability to secure funding have not been of funding to support innovation specifically. Also proposals to transfer innovation into Northern Ireland are limited.

⁶⁰⁹ firmus, OBP, pp. 18 – 20.

⁶¹⁰ firmus, ITT, p. 23.

- 7.8.29 On the basis of the above, the Authority confirms that its final decision to award a score of 12 out of 20 to firmus' application in relation to innovation and technology transfer.

7.9. Resources Criteria

- 7.9.1 As explained in chapter 2 of the provisional decisions⁶¹¹, the Authority considered there to be a close connection between an applicant's score with respect to the Best Value Criterion and the assessment of whether it has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion. This is because of the substantial overlap in the information which is relevant to each.
- 7.9.2 The Authority therefore used its detailed analysis of the information provided with respect to the Best Value Criterion, as outlined above, as a basis for its assessment of whether firmus has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion.
- 7.9.3 Where an applicant has achieved scores which are consistently within the medium to high parts of the range in the assessment of its OBP it might be expected that its application would reveal a broad adequacy of resources for the purposes of the licence. This is the case even if the Authority's detailed analysis of that applicant's OBP found there to be some inadequacies in the information provided.
- 7.9.4 Where an applicant has been attributed one or more scores which are within the low part of the range in the assessment of its OBP – in other words, where it has achieved less than half of the marks that are available against at least one element of sub-criteria 3.17(a) to (c) – the Authority has considered carefully whether its application reveals an adequacy of its resources.
- 7.9.5 firmus has been attributed scores which fall within the medium to high range in respect of all of the elements of its OBP. Its application was supported by

⁶¹¹ Chapter 2, paragraphs 2.7.23 to 2.7.29.

comprehensive, detailed and credible information, systematically addressed the relevant issues, and provided a clear and justified rationale.

- 7.9.6 In particular the Authority took into account that its proposed WACC of 5.57% fell within NERA's plausible range and was such that it would be able to raise the finance required to construct and operate the low pressure network while subject to a revenue control condition embodying that WACC.
- 7.9.7 The Authority's final conclusion is that firmus has demonstrated that it has the required resources to meet the obligations of the licence and thus has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion.

8.0 firmus Low Pressure Unconnected

8.1. Introduction

8.1.1 This chapter:

- a. considers the application made by firmus energy (Distribution) Ltd (**firmus**) for the low pressure licence, which is not connected to any other application for a licence;
- b. the responses received to the consultation on the provisional decisions, as these relate to the connected application made by firmus
- c. sets out the Authority's final conclusions as to whether firmus has met each of the criteria other than the Best Value Criterion;
- d. sets out the Authority's final assessment of the marks to be awarded to firmus in respect of the different elements of the Best Value Criterion;
- e. explains the reasons of the Authority for its final conclusions and marks.

8.1.2 In this chapter, the criteria have been addressed in the order in which they are set out in Chapter 2 of the provisional decisions, and the Authority has followed the approach to interpreting and applying the criteria that is set out in that chapter.

8.2. The Information Criterion

8.2.1 Both an electronic and a printed copy of the firmus application were received by the Authority before the deadline of noon on 6 May 2014

8.2.2 Once the deadline had passed the application was opened and checked for completeness against a pre-prepared checklist. The application was assessed as being complete except in two respects:

- a. it was not clear from the application what information was being relied on by firmus for the purposes of meeting the Adequate Resources Criterion; and
 - b. it was not clear from the application what information was being relied on by firmus for the purposes of meeting the Financial Resources and Standing Criterion.
- 8.2.3 firmus was informed of these apparent omissions and was given until noon on 14 May 2014 to provide the missing information. A response was received by the deadline and it was subsequently judged that this addressed the omission in full⁶¹².
- 8.2.4 Having considered these facts, the Authority concluded that firmus has provided all the information requested by the Authority, in such manner and by such times as was specified, and therefore meets the Information Criterion.

8.3. The Constitution Criterion

- 8.3.1 firmus is a limited company with its registered office in England. firmus's constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations⁶¹³.
- 8.3.2 Having considered this evidence, the Authority was satisfied that firmus has demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.

8.4. The Fit and Proper Person Criterion

- 8.4.1 Evidence to demonstrate that firmus is a fit and proper person was provided to the Authority in accordance with paragraphs 20 to 26 of Schedule 2 to the Application Regulations⁶¹⁴. It consisted of a signed statement by a senior officer

⁶¹² Response to UR 14 May (3)

⁶¹³ Application Form and Appendix 1 Independent Application (ICON) Ownership

⁶¹⁴ Ibid

of firmus to the effect that firmus had no information to disclose under any of those paragraphs.

- 8.4.2 The Authority noted that firmus has no record of enforcement action being taken against it, or any other adverse factor of the type listed in the Application Regulations.
- 8.4.3 On the basis of the evidence provided to it, the Authority was therefore satisfied that firmus meets the Fit and Proper Person Criterion.

8.5. Specific Criteria – Operational Business Plan 3.17(a)

Engagement with stakeholders

- 8.5.1 In section 1.2 of its OBP, firmus states that it already has excellent working relationships with key industrial and commercial customers and stakeholder groups in Northern Ireland (including National Energy Action Northern Ireland, the Consumer Council for Northern Ireland (CCNI) and the Department for Regional Development (DRD)) and that it will continue these strong relationships in relation to the operation of the new licence⁶¹⁵.
- 8.5.2 firmus states that throughout the development of the Ten Towns network it has proactively engaged at every opportunity with stakeholders and has always striven to promote excellent working relationships with the Authority, DETI, CCNI, DRD, Health and Safety Executive Northern Ireland (HSENI), Energy Saving Trust (EST), the Carbon Trust and NEANI⁶¹⁶.
- 8.5.3 firmus outlines its proposals regarding stakeholder engagement in sections 7.2.1 and 7.4.1 of its OBP. In section 7.2.1, firmus provides a stakeholder engagement map in the form of a table (figure 7.2.1)⁶¹⁷. The stakeholder engagement map outlines a range of stakeholder groups and organisations (statutory and otherwise) and outlines in respect of each the person within firmus who is responsible for engagement.

⁶¹⁵ firmus, *Gas to the West: Operational Business Plan*, p. 6.

⁶¹⁶ Ibid, p. 3.

⁶¹⁷ Ibid, p. 65.

- 8.5.4 In section 7.4.1, firmus states that from the award of the licence it will commence a series of structured briefings to ensure that these stakeholder groups are kept well informed of plans and progress. Separate Key Influencer road shows will take place in each town, 9–12 months ahead of ‘gas live’, with an extended stakeholder audience to include local head teachers, religious leaders, key business owners, local chambers. firmus states that this will ensure that all influencers in a town are kept abreast with network plans ahead of network build commencing. firmus also states that its current press office will be extended to encompass its activities under the licence to provide a contact channel for all stakeholders and that regular briefings and updates will be provided on an on-going basis⁶¹⁸.
- 8.5.5 firmus states that it will undertake a series of tactical public relations campaigns to promote the specific benefits and features of natural gas on a regular basis to potential customers and help to stimulate demand from domestic households. This activity will be coordinated with its engineering, advertising and sales activity ensuring an integrated and efficient approach is maintained⁶¹⁹.
- 8.5.6 In its OBP firmus also provides information in relation to the stakeholder engagement which it has already undertaken. For example, firmus has held a number of pre-meetings with stakeholders, DRD in relation to proposed works in the new area, NI Water to investigate dual trench opportunities, and NIE in relation to opportunities for joint infrastructural development and the potential for gas supply to replace existing Economy 7 domestic heating loads⁶²⁰.
- 8.5.7 In terms of its proposed engagement with other stakeholders which it has identified, firmus points to the advantages to be gained from its partnership with BGE(UK). It states that this partnership provides synergies which firmus and BGE(UK) have demonstrated over the past ten years in the construction of the Northwest pipeline, South North pipeline, steel spur lines and the connection of towns along those pipelines. Examples of such synergies include (i) the provision of a single point of contact with statutory bodies and the public, (ii) public consultations, third parties.

⁶¹⁸ Ibid, p. 76.

⁶¹⁹ Ibid.

⁶²⁰ Ibid, p.27 - 28.

- 8.5.8 firmus states that both companies will engage frequently with DRD, MLA's and local councillors to keep elected representatives aware of the on-going works and any proposed disruption that may be incurred in their borough.
- 8.5.9 The Authority considers that firmus has demonstrated that it has identified an appropriate range of stakeholders and has outlined proposals in respect of engagement with those stakeholders. It has also demonstrated that engagement with some stakeholders has already taken place.

Skills and experience of key members of staff and any other persons

- 8.5.10 In its OBP, firmus provides information in relation to the skills and experience which it has built up, as an organisation, from its current low pressure licence activities in relation to the Ten Towns. firmus has installed over 870km of mains and over 22,000 industrial and commercial and domestic services since construction began on the Ten Towns network⁶²¹.
- 8.5.11 firmus points to the similarity between the Ten Towns and the network to which the licence relates. It states that the Ten Towns network was developed through a similar mobilisation process to that envisaged in relation to the low pressure network and with the similarities in the two networks firmus submits that it is well placed to extend its experience from Ten Towns to the resources required for the efficient construction, operation and maintenance of the new network⁶²².
- 8.5.12 In particular, firmus states that the senior management team in respect of the activities to be undertaken under the licence is already in place and that its existing engineering management structure will be responsible for the roll out of the network in the new licensed area⁶²³. Key personnel are named and curricula vitae provided⁶²⁴. Also, the existing Head of Sales will have overall responsibility for all connection sales activities in the new licensed area⁶²⁵.

⁶²¹ Ibid, p. 2.

⁶²² Ibid, p. 3.

⁶²³ Ibid, p.10.

⁶²⁴ Ibid, pp. 18 – 20.

⁶²⁵ Ibid, p.12.

- 8.5.13 However, given the increase in activity other staff such as engineers and sales staff need to be recruited (23 in all)⁶²⁶. firmus also intends to employ a consultant to work with the Commercial Development Manager in providing conversion project management to large industrial users⁶²⁷.
- 8.5.14 A contract with McNicholas Construction Services is already in place for the period 2014-2020 and firmus envisages that this contractor will be used for the construction of the new network⁶²⁸. The OBP states that a contract is in place with National Grid for emergency call handling service and that this will be utilised for the new licensed area.⁶²⁹ The OBP also states that firmus intends to put in place an arrangement to cover maintenance and emergency response in the new licensed area similar to that currently in place with SGN for the Ten Towns.
- 8.5.15 The Authority considers that firmus has provided detailed information which illustrates that many of the staff with the skills and experience required to undertake the activities required by the licence are already in place within the organisation and that it has extensive experience of similar activities.
- 8.5.16 In relation to external skills and experience, the OBP sets out a range of arrangements which are already in place with contractors with respect to key activities or which can be extended to cover the new licensed area. Although the Authority cannot directly assess either the nature of the contracts which firmus has in place, or the skills and experience of the persons with whom it has such arrangements the experience upon which firmus can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate.

Management of risk

- 8.5.17 firmus sets out its risk management framework in section 4.1.2 of its OBP. This outlines how risk is identified and managed within the organisation through the

⁶²⁶ Ibid, figure 2.1.2a, p.10

⁶²⁷ Ibid, p.3.

⁶²⁸ Ibid, p.15.

⁶²⁹ Ibid, p.15.

use of five interrelated components, culminating in a risk radar and 'Key Risk Indicators' which are reviewed quarterly by firmus' Board⁶³⁰.

8.5.18 In section 4.1.1 it sets out the key risks which it has identified with respect to the Gas to the West project. These risks include (i) external risks such as environmental risks, risks around assets, local and political non-co-operation and customers willingness to convert to natural gas, and (ii) internal risks such as health and safety risks, management distraction, financial strain and the recruitment of qualified staff. The OBP sets out strategies to mitigate each of the identified risks based on firmus' experience in relation to the Ten Towns network⁶³¹.

8.5.19 Detailed construction and operational risk management procedures are set out in section 5.7.4 of the OBP and include discuss of damage to the gas network, critical mains, defective equipment and the use of a 'Dial B4U Dig' service for contractors and individuals who intend to carry out excavation work⁶³².

8.5.20 The Authority considers that firmus has identified, and suggested the mitigation of, a number of relevant risks associated with the activities which it would be required to undertake under the licence. It has also provided information illustrating that it has robust systems in place to deal with such risks.

8.5.21 This view is supported by the report from Rune⁶³³.

Tendering arrangements

8.5.22 In its OBP, firmus sets out detailed information regarding its tendering arrangements and demonstrates an understanding of best practice in this regard.

8.5.23 It states that accountability for ongoing development and management of procurement processes resides with the Financial Controller and its finance function, which will draw on legal advice as required⁶³⁴.

⁶³⁰ Ibid, p. 34 – 36.

⁶³¹ Ibid, p. 30 – 35.

⁶³² Ibid, p. 47 – 48.

⁶³³ RUNE Associates, *Gas to the West; Technical Advice on Low Pressure Submissions*, 14 June 2014, p. 2.

⁶³⁴ firmus, op cit, p. 52.

- 8.5.24 Policies and procedures to ensure compliance with EU procurement regulations are described and it is stated that procurement processes have been developed to comply not only with EU Utility procurement requirements, but also with more stringent Public Sector Procurement regulations⁶³⁵.
- 8.5.25 Detailed information is provided in the OBP regarding the arrangements which firmus has in place for tenders both above and below the EU threshold and financial approval levels set out⁶³⁶. firmus states, however, that it does not anticipate a requirement for an OJEU level competition at the mobilisation phase⁶³⁷.
- 8.5.26 In regard to materials, firmus states that existing contract arrangements, put in place in March 2014, can be applied during the mobilisation period. It states that it would anticipate that planning for competitive tendering arrangements for materials, construction, maintenance and specialist services will re-commence in 2019 to have a new contract in place by 2020⁶³⁸.
- 8.5.27 In regard to construction, maintenance and specialist services, firmus states that it is proposed to award a contract for Consulting Engineers to support industrial and commercial connections in the initial phase, which is anticipated to be below the £345,000 threshold and will be tendered according to its current processes⁶³⁹.
- 8.5.28 The primary essential service contract requirement is the framework contract for distribution network construction services. In section 2.2.1 of the OBP firmus states that McNicholas Construction services – contractor for period contract 2014 – 2020 in the Ten Towns network - will be responsible for providing a detailed programme of construction work and notifying all works in accordance with the NISRANS⁶⁴⁰ ensuring all works are completed in accordance with all relevant legislation, recommendations and industry best practice. It notes that McNicholas has extensive experience within the natural gas industry and has been the main gas contractor in Northern Ireland since 1996⁶⁴¹.

⁶³⁵ Ibid, p. 52.

⁶³⁶ Ibid, pp. 53 – 56.

⁶³⁷ Ibid, p. 28.

⁶³⁸ Ibid, p. 57.

⁶³⁹ Ibid.

⁶⁴⁰ Northern Ireland Street works Registration and Notification System.

⁶⁴¹ Ibid, p. 15.

- 8.5.29 Section 2.2 includes details of the proposals for procurement of the other essential services required which firmus states will be provided by extension of the contract arrangements with existing service providers. These services include activities such as emergency call handling (National Grid) and maintenance of network assets (SGN)⁶⁴².
- 8.5.30 The Authority considers that firmus has provided detailed information regarding its proposals as to the use of tendering arrangements and that its tendering arrangements are robust, in line with best practice and proven through use in its previous projects. The Authority notes that firmus will be able to utilise a number of contracts which it already has in place in relation to materials, construction and specialist services.
- 8.5.31 This view is supported by the report from Rune⁶⁴³.

Final score for criterion 3.17(a)

- 8.5.32 firmus has provided a comprehensive statement, backed by appropriate evidence, of how it will undertake the activities which would be the subject of obligations set out in the licence for which it has applied.
- 8.5.33 The Authority particularly notes firmus' proposals for engagement with stakeholders, its existing relationships are very strong and the fact that some engagement has already taken place. The Authority also notes firmus' previous experience in relation to the construction and operation of low pressure networks and that where skills and experience need to be sourced externally, contracts are in place or can be extended where required. Proposals for the management of risk and tendering arrangements were also robust.
- 8.5.34 On the basis of the above the Authority confirms that its final decision is to award 16 marks out of 20 to firmus in relation to subparagraph 3.17(a).

⁶⁴² Ibid, pp. 15 – 16.

⁶⁴³ RUNE Associates, op cit, p. 6.

8.6. Specific Criteria – OBP 3.17(b)

8.6.1 The Application Information Pack asked applicants to supply costs for WACC, Operating Expenditure and Mobilisation Costs and the Authority considers firmus' unconnected application submission of costs in this section. For the purposes of this paper the Authority dealt with the costs under two headings – WACC and Operating Expenditure Costs. The Authority's views on Mobilisation costs are included under the Operating Expenditure heading. The Authority set out in the Application Information Pack⁶⁴⁴ greater detail on what these costs might include.

Weighted Average Cost of Capital

8.6.2 NERA was requested to produce a report on what it would expect to see in a well-evidenced WACC submission. The Authority substantially agreed with the assessment reflected in that report. It follows the Authority would have expected to see:

- a. The cost of debt set out using: (i) a benchmark gilt yield (to reflect a risk free rate) plus evidence on corporate debt spreads with market evidence provided for both; and/or (ii) direct evidence of corporate debt yields with market evidence provided. For this purpose, references to corporate debt spreads/yields should reflect companies with similar risk profiles, issuance costs should be included in the cost of debt and the treatment of inflation should be clearly explained in the derivation.
- b. The cost of equity set out using CAPM and incorporating the risk free rate, equity risk premium and beta with relevant evidence provided to justify each component.
- c. The proposed gearing including a discussion on the how this interacts with the risks of the project, the proposed credit rating and the cost of debt.

⁶⁴⁴ Applicant Information Pack Annex 8

- 8.6.3 The application is based on a standard debt / equity capital structure and includes proposals for both debt and equity costs applying the CAPM model to propose a WACC range of 5.47-7.73% and a final figure of 5.57%.⁶⁴⁵
- 8.6.4 The Authority considers that the application provides reasonable detail and evidence as to how the final figure in the Data Input Workbook was arrived at.
- 8.6.5 On the cost of debt firmus set out two approaches which are used to calculate an upper and lower bound. The lower bound estimates a risk free rate and adds a corporate debt premium while the upper bound uses a 10 year average of an index of corporate debt setting out clearly which index is used and its reasons.
- 8.6.6 There is a reasonable discussion of some elements of the WACC such as the risk free rate and cost of debt although it is limited.⁶⁴⁶ There is some good evidence provided such as equity market returns and risk premium.⁶⁴⁷ The evidence is what would be expected in reviewing regulatory WACCs and the Authority views the evidence as robust.
- 8.6.7 There is a good discussion of issues around volume risk and the application includes some evidence of an effort to calculate the impact of volume risk using the CAPM model.⁶⁴⁸ Similarly there is a good discussion on construction risk⁶⁴⁹ and how this might impact on asset betas.
- 8.6.8 There are gaps in the explanation provided. For example there is no final table setting out the values for individual components of the WACC and how they interact to arrive at a final figure. There is a significant gap between the upper and lower bounds presented and the reasons given for the final figure⁶⁵⁰ do not reference the CAPM model.

⁶⁴⁵ firmus Unconnected OBP, p90

⁶⁴⁶ firmus Unconnected OBP, p90

⁶⁴⁷ firmus Unconnected OBP, p90

⁶⁴⁸ firmus Unconnected OBP, p91, footnote 16

⁶⁴⁹ firmus Unconnected OBP, p92

⁶⁵⁰ firmus Unconnected OBP, p89

- 8.6.9 There is limited description or evidence provided as to how the final values for key WACC components were arrived at. For example there is no clarity on what level of gearing is used.⁶⁵¹
- 8.6.10 In addition while the discussion on volume risk is good it is not clear what figure is actually used as part of the final WACC.

Operating Expenditure

- 8.6.11 Mobilisation costs were clearly and concisely explained in both the OBP⁶⁵² and in the appended Excel workbook ⁶⁵³. There are some figures e.g. buildings, which have limited explanation and are hard coded into the spreadsheet. However the largest cost line is manpower which makes up over 70% of mobilisation costs and this is explained in a comprehensive manner in both the OBP⁶⁵⁴ and the spreadsheet⁶⁵⁵.
- 8.6.12 Operating Expenditure is clearly and concisely explained in both the OBP⁶⁵⁶ and in the appended Excel workbook ⁶⁵⁷. The largest element is manpower costs which make up about one half of controllable operating expenditure costs over the ten years and it is comprehensively explained in terms of manpower numbers⁶⁵⁸ and manpower costs with the spreadsheet⁶⁵⁹ providing greater detail on how the calculations are performed to reach the final figure.
- 8.6.13 The Authority notes that while there is a useful discussion of some other costs e.g. Marketing Development, Advertising and PR⁶⁶⁰, the final figure is not well explained.
- 8.6.14 The Authority also noted that the figure for Miscellaneous items is quite substantial at over 15% of controllable operating costs in years one to ten but the explanation for the costs included is limited.

⁶⁵¹ firmus Unconnected OBP, p91

⁶⁵² Operational Business Plan firmus Energy May 2014-Section 3.4

⁶⁵³ Mobilisation and supporting Schedules and Detailed Workings

⁶⁵⁴ firmus Unconnected OBP, p17, 23, 25, 26

⁶⁵⁵ Mobilisation and supporting Schedules and Detailed Workings

⁶⁵⁶ Operational Business Plan firmus Energy May 2014-Section 8.3

⁶⁵⁷ S Schedules and Detailed Workings

⁶⁵⁸ firmus Unconnected OBP, p17

⁶⁵⁹ Supporting Schedules and Detailed Workings, Manpower Summary sheet

⁶⁶⁰ firmus Unconnected OBP, p77

Identification and application of cost drivers

Operating Expenditure

- 8.6.15 Mobilisation - Cost drivers are clearly aligned with those used to forecast Operating Expenditure and applied on a constant basis across the OBP and the Data Input Workbook.⁶⁶¹ The spreadsheet⁶⁶² also sets out clearly how cost drivers lead to final proposed costs. The Authority does note that using employee headcount as a driver for professional and legal fees is not likely to be robust.
- 8.6.16 Operating Expenditure - Cost drivers are clearly stated, are based on direct Northern Ireland experience e.g. GD14 determination and applied on a constant basis across the OBP and the Data Input Workbook.⁶⁶³ The Authority notes that some costs are hard coded into the Spreadsheet e.g. market development and advertising⁶⁶⁴. This makes understanding the cost drivers more difficult.

Robustness of assumptions

- 8.6.17 The Authority identified and considered a number of assumptions that appeared to have been made by firmus when deriving the data contained in its Data Input Workbook.

The value of the WACC

- 8.6.18 First, the Authority took it to be implicit throughout the application that firmus had assumed it will be able to carry on the licensed activities under the low pressure licence, and to do so consistently with its obligations under that licence, on the basis of the proposed WACC. That is to say, there was an implicit assumption that firmus will be able to raise the finance required to construct and operate the low pressure network while subject to a revenue control condition embodying its proposed WACC.
- 8.6.19 For the purpose of testing this assumption, the Authority considered whether the proposed WACC fell within the range of what might reasonably be expected in

⁶⁶¹ Applicant Information Pack - Annex 8

⁶⁶² Mobilisation and supporting Schedules and Detailed Workings

⁶⁶³ Applicant Information Pack - Annex 8

⁶⁶⁴ Supporting Schedules and Detailed Workings, M,A&PR sheet

the context of the G2W project. To do this, it considered the market cost of debt and equity based on advice received from NERA, which took into account in its report such costs as referenced in recent regulatory decisions⁶⁶⁵. NERA advised on what it considered to be the 'plausible range' within which it would expect any WACC for this project to lie. The Authority relied upon the advice contained in the report as establishing a range against which to test firmus's assumption.

8.6.20 NERA established a 'plausible range' in respect of a corporate finance structure of between 3.5% and 6.2%. firmus's proposed WACC is 5.47%.

8.6.21 The Authority noted that the proposed firmus WACC lay at the high end of, but fell within, the range identified by NERA.

8.6.22 In addition firmus identified its ability and intention to finance the project through corporate finance from its parent BGE, and referenced the parents financial statements and its access to finance facilities⁶⁶⁶. It stated that it had already received the approval of its Board of Directors, so that financial resources were available to complete the project⁶⁶⁷. In addition it provided historical evidence that it had raised finance for construction of low pressure pipelines in Northern Ireland⁶⁶⁸. Assuming that the proposed purchase of firmus by ICON concluded on 30 June 2014 as anticipated firmus would no longer have access to finance from the BGE parent company. In this instance firmus referenced letters of comfort from a number of financial institutions, Royal Bank of Scotland and Lloyds⁶⁶⁹ and the history of ICON in raising finance to purchase regulated network utilities⁶⁷⁰.

8.6.23 The Authority considered that these letters of comfort did not represent a firm commitment by the relevant banks to provide the required financing. The letters note that any future funding commitment would be conditional on several factors, including credit market conditions, satisfactory due diligence, the final form of the legal documents and the licence, and other factors. They are not legally binding, nor do they purport to be so. Moreover, the Authority did not understand them to

⁶⁶⁵ NERA, Gas to the West, A report for the Utility Regulator

⁶⁶⁶ firmus Responses to Email from Utility Regulator, 9th May 2014

⁶⁶⁷ Ibid

⁶⁶⁸ Ibid

⁶⁶⁹ Appendix 1 Independent Application – ICON Ownership

⁶⁷⁰ Ibid

commit the banks in any sense that might properly be regarded (even allowing that they fall short of a legal obligation) as entailing a 'firm' commitment.

- 8.6.24 In order to clarify whether its understanding of the status and effect of the comfort letters was correct, the Authority sought advice from both NERA⁶⁷¹ and the Strategic Investment Board⁶⁷². Each of them confirmed the Authority's initial view that there was significant conditionality attached to the letters, including in relation to due diligence and internal bank clearances. The Strategic Investment Board noted that while the letters 'certainly indicate willingness from the funders concerned to participate in the project', it did 'not believe that the letters can be relied upon as evidence'. The Authority accepted this advice.
- 8.6.25 This did not entail any conclusion that the letters of comfort were inappropriate. The Authority recognised that funding commitments are likely to be contingent on, and related to the conditions of, the licence as granted; in particular on the terms of the price control which determine the value of the income stream that can be generated by the licence holder.
- 8.6.26 Moreover, the Authority did not consider that there was any ground for materially distinguishing between the weightings between applicants. It accepted the advice of the Strategic Investment Board in this respect.
- 8.6.27 However, while accepting that a comfort letter indicates a willingness on the part of the relevant funder to participate in the project, the Authority considers that no material degree of weight can be attached to such letters for the purposes of demonstrating firmus' cost of debt.
- 8.6.28 Given that the proposed purchase of firmus by ICON was completed the Authority focused on the evidence presented in relation to ICON.
- 8.6.29 Having regard to its own expertise, the Authority considered that the proposed WACC was high and therefore reflective of a cost of debt and equity that would attract investors. Given that the WACC also lay within NERA's plausible range, and given the historical evidence presented, the Authority had no concerns

⁶⁷¹ NERA, Gas to the West, A report for the Utility Regulator p.21.

⁶⁷² SIB – Letter to Uregni (2).

about the ability of firmus to finance its activities under the low pressure licence on the basis of the proposed WACC.

- 8.6.30 Therefore the Authority concluded that the assumption that firmus would be able to obtain financing to carry on the licensed activities on the basis of the proposed WACC was robust.

Asset Beta

- 8.6.31 The discussions on construction risk suggest that it would be appropriate to compare this pipeline with PFI projects or Terminal 5 at Heathrow. The reasons why this would be the case are not well evidenced and the Authority does not find the assumption robust. However the Authority does note that such risks appear not to have been included in the final WACC.
- 8.6.32 There is a request in the discussion on volume risk that the return to be applied to under recoveries is the full WACC⁶⁷³. This is inconsistent with the return which was clearly set out in the application pack⁶⁷⁴ and the Authority regards the request as confusing and questions if firmus have based its application on incorrect assumptions.

Operating Expenditure

- 8.6.33 Operating Expenditure - Assumptions are clearly stated and applied on a consistent basis and are based on reliable evidence from the GD14 price control determination e.g. manpower costs.

Evidence verifiable from previous experience

- 8.6.34 Northern Ireland specific experience has been drawn upon in the identification and application of cost drivers when forecasting future Operating Expenditure levels. There is a particular application of GD14 determined allowances e.g. manpower costs⁶⁷⁵ and this provides for robust figures.

⁶⁷³ firmus Unconnected OBP, p91.

⁶⁷⁴ Applicant Information Pack, paragraph 3.56 & 3.57.

⁶⁷⁵ firmus Unconnected OBP, p26

- 8.6.35 We note that when estimating the cost of debt the application uses a trailing average over a ten year period. While this is reasonable it would have been an improvement to consider how this interacts with current market evidence.⁶⁷⁶

Identification and quantification of risk

Operating Expenditure

- 8.6.36 There is a limited discussion of risks⁶⁷⁷, including identification of some risk factors and a discussion about possible mitigating factors.
- 8.6.37 The Authority views that the identification of risk is limited. The Authority would have expected some underlying risks which might impact on costs to be identified.
- 8.6.38 The Authority notes that there is no quantification of the probability of a risk occurring nor is there any quantification of the impact on outputs. This appears to be inconsistent with the companies stated approach to risk which includes the quantification of the impact of the risk and the likelihood of the event occurring⁶⁷⁸.
- 8.6.39 Therefore the Authority concludes that while there has been a reasonable identification of some risks there is no evidence that they have been quantified.

Efficiency improvement plan

- 8.6.40 The efficiency improvement plan⁶⁷⁹ covers efficiencies included in the proposed costs because of economies of scale as well as referencing the ITT section as providing cost efficiencies.
- 8.6.41 The plan also mentions the contribution of smart meters, computer tablets and benchmarking as contributing towards efficiency.
- 8.6.42 The evidence provided in this application lacks any quantification of the benefits. For example there is no analysis of how the benefits of smart meters would outweigh the costs.

⁶⁷⁶ Applicant Information Pack Annex 8 Low Pressure Workbook Notes.

⁶⁷⁷ firmus Unconnected OBP, p80

⁶⁷⁸ firmus Unconnected OBP, p35

⁶⁷⁹ firmus Unconnected OBP, p82

8.6.43 The Authority also does not think the argument that benefits from scale economies, which are already built into the cost forecasts constitutes an efficiency improvement plan.

8.6.44 While the use of benchmarking⁶⁸⁰ is a good example of how cost improvement can be driven overall the Authority finds the application lacks evidence of a strong efficiency improvement plan delivering quantified benefits.

Final score for criterion 3.17(b)

Weighted Average Cost of Capital

8.6.45 The evidence presented in this application in support of the WACC was reasonably well evidenced but gaps in the explanation were identified.

8.6.46 Overall the Authority finds that in relation to the Weighted Average Cost of Capital the application to be of moderate quality when judged against sub criterion 3.17b. Although the Authority recognises that both the methods and evidence used to estimate the value of the various WACC components are robust the application fails to set out in sufficient detail how final values were arrived at and how these in combination resulted in the derivation of the WACC figure in the Data Input Workbook.

Operating Expenditure

8.6.47 Overall the build up of mobilisation and operating costs was very well evidenced although the analysis of risk and the efficiency improvement plan were of a much lower standard. Overall this part of the submission could be described as high to moderate.

Final conclusion

8.6.48 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the firmus application should attract a medium score, and its final decision is to award 14 out of 20 marks.

⁶⁸⁰ firmus Unconnected OBP, p83-84

8.6.49 The Authority compared this mark with those provisionally awarded to the other low pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.

8.6.50 When compared with the other applications, the Authority considered that the firmus application was better than the others in relation to Operating Expenditure in that a spreadsheet had been included and no errors were identified although more detail could have been provided in some areas. On the other hand the submission in relation to WACC fell between the other two submissions in that the derivation of WACC was not fully explained and not as comprehensive as SGN. However it was substantially better evidenced than the PNGL submission.

8.7. Specific Criteria – Operational Business Plan 3.17(c)

The experience of the applicant and others on whom it intends to rely in relation to network construction

8.7.1 As discussed above, firmus has installed over 870km of gas mains and over 22,000 services throughout within its existing licensed area⁶⁸¹. The construction team within firmus has been responsible for designing the network roll out as well as associated customer installations for both domestic and large industrial and commercial customers.⁶⁸²

8.7.2 firmus points to the similarity between the its existing Ten Towns network and the network to which the licence relates and states that its existing network was developed through a similar mobilisation process to that envisaged in relation to the new network. Given the similarities in the two networks firmus submits that it is well placed to extend its existing experience to the resources required for the efficient construction and operation of the new network⁶⁸³. The Authority places weight on firmus' recent experience in constructing low pressure pipelines in Northern Ireland.

⁶⁸¹ Ibid, p.10 and section 3.6.

⁶⁸² Ibid, p. 11.

⁶⁸³ Ibid, p. 3.

- 8.7.3 As well as experience at corporate level, firmus also provides details of the skills and experience of the senior management team which will oversee the initial phase of activity under the licence until a management team in Northern Ireland is recruited⁶⁸⁴.
- 8.7.4 In relation to external skills and experience, firmus has a contract in place with McNicholas Construction Services covering the period 2014-2020 and firmus envisages that the construction of the new network will take place under this contract⁶⁸⁵. McNicholas has constructed the existing firmus network in the Ten Towns area⁶⁸⁶. However, firmus has also indicated that it would be happy to discuss tendering for Mains and Service laying services if deemed appropriate⁶⁸⁷. The Authority places weight on the fact that firmus has a current contract in place with McNicholas
- 8.7.5 Although the Authority cannot directly assess either the nature of the contract which firmus has in place with McNicholas, the experience upon which firmus can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate. The Authority also places weight on the fact that McNicholas has experience of constructing low pressure networks in Northern Ireland.
- 8.7.6 The Authority considers that firmus has demonstrated that in relation to the construction of the network it has appropriate skills and experience both within the company and in the contractor for the construction on whom it will rely.
- 8.7.7 This view is supported by the report from Rune⁶⁸⁸.

The experience of the applicant and others on whom it intends to rely in relation to network operation

- 8.7.8 firmus currently operates the low pressure network in its existing licensed area and has done so since 2005⁶⁸⁹. It has an asset management system in place⁶⁹⁰,

⁶⁸⁴ Ibid, pp. 18 – 20.

⁶⁸⁵ Ibid, p. 15.

⁶⁸⁶ Ibid, p. 11.

⁶⁸⁷ Ibid, p. 23.

⁶⁸⁸ RUNE Associates, op cit, p. 10.

⁶⁸⁹ firmus, op cit, section 1.3 and chapter 5.

⁶⁹⁰ Ibid, section 5.6 and 5.7.

and a Transportation Services Team which manages the network code and is responsible for, among other things, customer switching and the allocation of gas flows to suppliers⁶⁹¹.

8.7.9 firmus states that it has developed procedures and processes to monitor its existing network and to respond effectively to incidents to both ensure the safety of the general public and its personnel, and maintain security of supply⁶⁹². Section 5.7 of the OBP describes asset management processes and section 5.7.1 indicates that firmus operates a system of annual inspection on all of its sites which fall under the governance of the PSSR: 2000. It also carries out function checks on safety devices and condition assessments of all equipment installed at these sites at the same visit⁶⁹³.

8.7.10 In relation to external skills and experience, firmus relies on BGE for system control arrangements in place for its existing network. firmus utilises Technolog's PMAC⁶⁹⁴ system to monitor the distribution system at key locations within each town with alarms sent to the Bord Gais Network control centre in Finglas⁶⁹⁵. However, it is not clear from the OBP whether this service from Bord Gais will continue once ownership of firmus is transferred to iCon.

8.7.11 firmus also indicates that contracts are in place with SGN for maintenance and emergency response on the network and with National Grid to handle emergency calls from the public to the Northern Ireland Emergency Gas Number⁶⁹⁶. The OBP indicates that the contract with National Grid will cover the new licensed area⁶⁹⁷. However, it is not clear if the current contract with SGN will be extended to the new licensed area as firmus merely states that 'a similar arrangement will be put in place for Gas to the West'⁶⁹⁸.

8.7.12 The Authority considers that firmus has demonstrated that in relation to the operation of the network it has appropriate skills and experience within the

⁶⁹¹ Ibid, p. 46.

⁶⁹² Ibid, p. 3.

⁶⁹³ Ibid, p. 50.

⁶⁹⁴ Pressure Monitoring and Control.

⁶⁹⁵ Ibid, p. 45.

⁶⁹⁶ Ibid, p. 15 and section 5.8.

⁶⁹⁷ Ibid, p.15.

⁶⁹⁸ Ibid.

company based on its experience in operating a similar network in Northern Ireland.

8.7.13 This view is supported by the report from Rune⁶⁹⁹.

Securing, mobilisation and management of resources

8.7.14 As stated above, firmus indicates that it envisages a similar mobilisation process to that used for its existing network. firmus states that through its existing business, it already has internal operating teams, processes and procedures, external agencies, contractors, stakeholder relations and a governance structure in place⁷⁰⁰.

8.7.15 In relation to the mobilisation of internal resources necessary to construct a low pressure network, firmus states that the current senior management team will manage the business in the new licensed area with the Head of Engineering having overall control of the mobilisation project⁷⁰¹. Also, additional internal resources will be deployed from each of the functional areas of expertise such as engineering and sales and marketing⁷⁰².

8.7.16 Any increase in personnel will be at the lower levels of the organisation structure and figure 2.2.3 provides a detailed summary of the additional manpower roles which are required, categorised by department, role, pay band and date⁷⁰³.

8.7.17 firmus states that it has the relevant information systems in place (such as felive, GIS and Oracle⁷⁰⁴) to provide management information required to manage the new distribution network.⁷⁰⁵

8.7.18 In relation to the mobilisation of external resources the OBP indicates that a number of contracts are already in place. As noted above, the contract with McNicholas for construction is already in place and can be used for the new licensed area. A contract is also in place with GL Noble Denton to provide

⁶⁹⁹ RUNE Associates, op cit, p. 12.

⁷⁰⁰ firmus, op cit, p. 9.

⁷⁰¹ Ibid, p. 22.

⁷⁰² Ibid, p. 23.

⁷⁰³ Ibid, p. 17.

⁷⁰⁴ Felive facilitates project costing and management, transportation services, site works and sundry service billing. GIS facilitates network mapping and asset management while ORACLE supports procurement, accounts, and financial reporting.

⁷⁰⁵ firmus, op cit, p.29.

services in order to ensure compliance with the requirements of the Pressure Systems Safety Regulations and firmus state that services will be provided by a senior engineer from GL Noble Denton who will visit firmus energy every three months to sign off the pressure systems in the new licensed area⁷⁰⁶.

8.7.19 Also, in relation to the mobilisation of external resources the Authority would have expected firmus, in its unconnected application, to have given consideration to how it will manage its relationship with a TSO it may not be connected to.

8.7.20 In addition, firmus states that an industrial engineering consultant will be employed to work closely with the Commercial Development Manager (CDM) for the purpose of accelerating industrial connections to the network and to project manage industrial customers through the conversion process. The consultant has not been identified although firmus states that this resource will be recruited via an industry recognised employment agency such as Wilcock Consulting⁷⁰⁷.

8.7.21 The Authority considers that firmus has provided detailed proposals on securing, mobilisation of, and management of, the internal and external resources necessary to construct the low pressure network. The Authority particularly notes firmus' previous experience in this regard in Northern Ireland.

8.7.22 This view is supported by the report from Rune⁷⁰⁸.

The experience of the applicant and others on whom it intends to rely in relation to achieving connections

8.7.23 firmus indicates that it has a strong track record of achieving connections in its existing licensed area which was not previously supplied with gas. firmus states that it has connected 4,250 customers per annum, with 22,000 customers connected overall⁷⁰⁹.

8.7.24 As the Authority would expect, firmus recognises that the development of a network of installer and retailers is crucial to future connection growth. In

⁷⁰⁶ Ibid, pp. 15 – 16.

⁷⁰⁷ Ibid, p. 3 and 22.

⁷⁰⁸ RUNE Associates, pp.16 and 21.

⁷⁰⁹ firmus, op cit, p. 1.

- particular, firmus points to its experience in its existing licensed area of developing a network of local installers and associated trades, including natural gas retailers, manufacturers, plumbing suppliers and trade publications. firmus states that over 50 installers are currently registered with it and that all of these installers are Gas Safe registered⁷¹⁰.
- 8.7.25 firmus also points to other customer and stakeholder relationships that it has developed as part of the process of generating connections in its existing licensed area. Such stakeholders include local councils and road authorities⁷¹¹ and the majority of the 20 largest industrial users identified in the Fingleton McAdam design⁷¹².
- 8.7.26 The Authority notes that firmus has assessed the opportunity for connections both in total and by town in the new licensed area. In particular, firmus has provided a table of the number of 'addressable properties' in each town⁷¹³ and states that it has profiled the demographic make-up of the new area using its experience in the Ten Towns network to create a marketing and sales plan to deliver the connection targets⁷¹⁴.
- 8.7.27 As part of its proposals to achieve connections, firmus states that it plans to extend its local installer network to the new licensed area⁷¹⁵. It also emphasises that it also has a close working relationship with Gas Safe⁷¹⁶.
- 8.7.28 firmus states that it intends to employ a consultant to work with its Commercial Development Manager in providing conversion project management to large industrial users. However, as discussed above, that person has not yet been recruited.
- 8.7.29 The firmus submission also makes reference to the importance of the existing firmus brand. The Authority notes that, in regard to connections, firmus is the only applicant for the low pressure licence to note that 'synergies could be derived in rolling out uniform natural gas brand messaging for Northern

⁷¹⁰ Ibid, p. 68.

⁷¹¹ Ibid, p. 7.

⁷¹² Ibid, p. 7.

⁷¹³ Ibid, figure 7.1.1e, p. 62.

⁷¹⁴ Ibid, p. 60.

⁷¹⁵ Ibid, p. 68.

⁷¹⁶ Ibid, p. 15.

Ireland⁷¹⁷. This is consistent with the proposed licence condition set out in the Application Information Pack.⁷¹⁸

- 8.7.30 The Authority considers that firmus has provided detailed information in relation to its experience of achieving connections in an area not previously supplied with gas through a gas network and, drawing on that experience, has made relevant proposals in relation to the new licensed area.

Developing relationships with business and social landlords

- 8.7.31 firmus affirms the importance of developing the relationships necessary to drive connections and sets out its experience and existing relationships in its current licensed area. firmus states that it is leveraging existing relationships within its existing Ten Towns network and the Greater Belfast network to talk to large commercial customers about load information surveys, and that meetings are being conducted with other large potential users⁷¹⁹.
- 8.7.32 In its existing licensed area, firmus uses energy advisors to manage relationships with businesses and a Commercial Development Manager to manage its relationships with large customers. In its OBP, firmus indicates that it will replicate this approach in the new licensed area.
- 8.7.33 firmus points to the fact that every large potential contract site in each town has been surveyed by their Commercial Development Manager and a database has been compiled outlining contact details, existing fuel usage/cost, existing plant, likelihood to convert/cost, proposed future energy requirements and potential utilisation of new and more efficient technologies (such as Combined Heat and Power)⁷²⁰. firmus states that it already has existing relationships with potential business customers in the new licensed area such as Dale Farm, Moy Park, Kerry Foods, Linden Foods, WHSCT, NHSCT and Education and Library Boards⁷²¹.

⁷¹⁷ Ibid, p. 84.

⁷¹⁸ Applicant Information Pack, paragraph 3.68

⁷¹⁹ Ibid, p. 28.

⁷²⁰ Ibid, p. 64.

⁷²¹ Ibid.

- 8.7.34 In addition, firmus also points to the fact that it has previously worked with NIHE appointed contractors and NIHE Regional planners in the west of Northern Ireland (H&A Mechanical and BC Energy)⁷²².
- 8.7.35 firmus states that it has met with NIHE district planners and has obtained details of its future Heating Replacement Programme in the new licensed area⁷²³.
- 8.7.36 The Authority considers that firmus has provided detailed information in regard to its existing relationships with businesses and NIHE and its proposals to build on these relationships to maximise the number of premises connecting to the new network.

Connections to vulnerable customers

- 8.7.37 firmus puts forward information in regard to vulnerable customers in section 7.2.3 of its OBP. It states that it has engaged in several partnerships with Bryson Energy, including a 'Winter Warmth Scheme' which helps most vulnerable customers improve energy efficiency in their homes. This free service was designed for customers in firmus' network area outside of greater Belfast who were more than 60 years old and either living alone or with a minor, and who have a disability or are chronically ill. The scheme offered a home visit from a professionally trained Bryson Energy representative who reviewed the customer's energy bills, ensured that they were fully aware of how to get the best use from their natural gas heating system and referred those who were eligible to any suitable energy efficiency schemes⁷²⁴.
- 8.7.38 firmus states that a similar initiative is currently on-going and that it intends to replicate this initiative in the new licensed area.
- 8.7.39 firmus states that its energy advisors also actively source referrals and promote the Warm Homes Scheme introduced by the DSD to tackle fuel poverty. The scheme provides a package of free energy efficiency and heating measures to residential home-owners and those who rent from private landlords on a qualifying benefit.

⁷²² Ibid, p. 71.

⁷²³ Ibid, p. 71.

⁷²⁴ Ibid, p. 72.

- 8.7.40 firmus also points to the fact that it has secured £1.2million of Northern Ireland Sustainable Energy Project (NISEP) funding, which will be utilised to assist vulnerable customers in paying for conversion from solid fuel/electricity or solid fuel heating to natural gas heating.⁷²⁵
- 8.7.41 However, the OBP does not quantify firmus' success in connecting vulnerable customers as a consequence of these measures.
- 8.7.42 The OBP lists a number of other measures that firmus currently apply in the Ten Towns area and states that these will be extended to vulnerable customers in the new licensed area. These measures include the use of prepayment meters, working with Gas Safe to promote the installation of high efficiency Sedbuk 'A' rated boilers, and the firmus care scheme⁷²⁶.
- 8.7.43 The Authority notes that while all of the measures which firmus describes will assist vulnerable customers once connected, the application does not explain clearly how some of these measures will assist in actually promoting connections to these customers as required by paragraph 3.20(b)(iv) of the Criteria.

Final score for criterion 3.17(c)

- 8.7.44 The Authority considers that firmus has provided detailed information in respect of most of the elements of subparagraph 3.20(b) of the Criteria. The information which it has provided in relation to subparagraph 3.20(b)(iv) is not strictly relevant to the requirements of that subparagraph, however.
- 8.7.45 The Authority particularly notes firmus' experience of network construction and operation and its proposals for mobilisation based on its experience in its existing licensed area. Proposals for connections were also well evidenced and the Authority notes in particular that firmus has existing relationships with local installers, business, and other stakeholders and has recognised the importance of a uniform natural gas brand. firmus has also provided a table of the number of

⁷²⁵ firmus Connected OBP, p.3.

⁷²⁶ firmus Connected OBP, pp.72-73.

‘addressable properties’ in each town⁷²⁷ and has profiled the demographic make-up of the new area.

8.7.46 However, the Authority notes that it is not clear whether all services currently provided by Bord Gais will continue once ownership of firmus is transferred to iCon.

8.7.47 On the basis of the above the Authority confirms that its final decision is to award 16 marks out of 20 to firmus' application in relation to paragraph 3.17(c).

8.8. Specific Criteria – Innovation & Technology

8.8.1 firmus has sought to address innovation and technology transfer in a standalone document (the ITT) submitted as part of its application which considers the matters listed in paragraph 3.21 of the Criteria systematically.

8.8.2 The Authority notes that the ITT submissions in firmus' connected and unconnected applications are identical.

Environmental sustainability

8.8.3 In relation to measures to ensure sustainability with respect to the environment, firmus points to a number of no-dig technologies with benefits in terms of environmental sustainability such as trenchless gas mainlaying and tensile loading. firmus also states that it will consider building upon Bord Gais Networks' experience to provide a site within the new licensed area for a compressed natural gas (CNG) station to initially fuel both firmus vehicles and those of its customers⁷²⁸.

8.8.4 firmus also provides some discussion of measures to reduce the impact of its business on the environment, such as pointing to the fact that it has attained the CORE corporate responsibility standard from Business in the Community Northern Ireland. It also lists a number of measures that it will undertake in the new licensed area such as Carbon Trust audits, examining opportunities to work with other utilities (such as NIE and NI Water) on dual trenching and

⁷²⁷ firmus Unconnected OBP, figure 7.1.1e, p.62.

⁷²⁸ firmus, Gas to the West: Innovation and Technology Transfer, p. 5.

reinstatement activities, and having a policy which ensures that it sends zero recyclable waste to landfill⁷²⁹.

Efficiency in gas and new sources of gas

8.8.5 There are a number of proposals for efficiency in the use of gas under the heading of distribution network innovation, e.g. remote pressure regulation and district pressure monitoring. However, firmus has not demonstrated clearly how these examples promote efficiency in the use of gas.

8.8.6 As stated above in 2.9.1 where the applicant is applying for a low pressure licence the Authority would expect to see evidence of innovative technologies to reduce customer's consumption of gas. In this respect firmus proposes the use of Climote⁷³⁰ in suitable homes in the new licensed area⁷³¹. firmus also states that it has identified a number of customers in the new licensed area who could benefit from decentralised heating and installation of Combined Heat and Power. It states that it has identified three opportunities for decentralised heating and ten loads which are potentially suitable for medium/large scale Combined Heat and Power installations.⁷³²

Cost efficiency

8.8.7 In relation to cost efficiency, firmus points to specific engineering projects and identifies cost savings for some of them, such as AGI positioning⁷³³.

8.8.8 firmus also references stakeholder engagement as a means to achieve cost efficiency but has not demonstrated how this contributes to cost efficiency⁷³⁴.

Development of the network to more remote geographical areas

8.8.9 The development of the gas network is dealt with in section 11.4 of the ITT. This predominantly highlights successes in developing the existing network as

⁷²⁹ Ibid, p. 7

⁷³⁰ Climote is a smart energy controller which allows domestic customers to control their heating from any computer or enabled smart device.

⁷³¹ firmus, ITT, section 11.1.

⁷³² Ibid, p. 8.

⁷³³ Ibid, p. 12-13.

⁷³⁴ Ibid, p. 11

evidence for how firmus would develop the new licensed area⁷³⁵. However, this explanation is not tailored to innovation in relation to the development of the network to more remote geographical areas.

History of innovation

8.8.10 firmus cites a number of examples of previous innovation in section 11.5, including its work related to the Craigavon Bridge, fitting of excess flow valves, and the use of off-site construction methods.

8.8.11 The Authority considers that these examples may be directly relevant to the network in the new area and illustrate an ability to innovate more generally.

8.8.12 This view is supported by the report from Rune⁷³⁶.

Ability to secure funding

8.8.13 firmus points to the fact it has a dedicated Energy Advisor who specialises in managing government and regulatory Authority funding⁷³⁷.

8.8.14 In addition, firmus states that it has secured funding from a number of different sources. In particular firmus points to the fact that it is the only gas distribution network operator to avail of NISEP⁷³⁸ and has secured £1.2m worth of funding for 2014/15 and similar funding in 2013/14. firmus expect that this type of funding will be important in supporting residential connections in the new licensed area⁷³⁹. firmus also points to the fact that it has worked with the Energy Saving Trust (EST) to gain a NISEP grant of £60,000 towards the costs of installing a gas-fired combined heat and power unit to supply electricity and hot water to the main Daisy Hill Hospital Building in Newry⁷⁴⁰.

8.8.15 firmus points to the boiler replacement allowance funded by the NI Executive and the Warm Homes Scheme funded by DSD but it is not clear, particularly in

⁷³⁵ Ibid, p. 14 – 15.

⁷³⁶ Rune Associates, op cit, p. 24.

⁷³⁷ firmus, ITT, section 11.6.

⁷³⁸ Ibid, p. 20

⁷³⁹ Ibid, p. 21.

⁷⁴⁰ Ibid.

relation to the latter, that firmus have secured funding or whether they are assisting their customers in this regard.⁷⁴¹

8.8.16 In relation to staff development, firmus states that it has received £20,000 funding from Energy & Utility Skills (EUS) for energy efficiency and skills development training for its staff⁷⁴².

8.8.17 The Authority considers that firmus has provided some evidence of its ability to secure funding. However, the examples provided have not been of funding to support innovation. This view is supported by the report from Rune which also concludes that 'there is no direct evidence of securing funding for innovative developments.'⁷⁴³

Transfer of innovation into Northern Ireland

8.8.18 The Authority notes that firmus is in initial discussions with the Mountaineer Gas Company (MGC)⁷⁴⁴ to understand the latter's operations and whether it can transfer any innovations into the firmus business. However, the ITT does not reference any specific examples that firmus proposes to transfer to the new licensed area⁷⁴⁵.

8.8.19 As noted above, the submission also indicates that firmus will look to build upon Bord Gais Networks' experience of supporting a CNG infrastructure for its vehicles and those of its customers⁷⁴⁶.

8.8.20 The Authority considers that firmus has therefore provided limited proposals to transfer innovation into Northern Ireland.

8.8.21 This view is supported by the report from Rune which concludes that there is 'little by way of specific proposals to apply further innovative approaches to the G2W project'⁷⁴⁷.

⁷⁴¹ Ibid.

⁷⁴² Ibid, p.22.

⁷⁴³ RUNE Associates, op cit, p. 24.

⁷⁴⁴ firmus states that MGC serves over 220,000 customers and is the largest natural gas distribution company in West Virginia with around 5,600 miles of natural gas distribution pipeline. firmus ITT, p.22.

⁷⁴⁵ firmus, ITT, p. 22

⁷⁴⁶ Ibid, pp. 5-6.

⁷⁴⁷ RUNE Associates, op cit, p.24.

Existing skills and experience

- 8.8.22 firmus does not detail the existing skills and experience of its staff in relation to innovation. Instead, the application references firmus' competency management framework generally and refers back to section 2.3.2 of the OBP⁷⁴⁸. That section sets out the qualifications and experience of key staff but does not specifically consider innovation and technology transfer in this regard.
- 8.8.23 There is reference to a skills transfer programme with the aim of ensuring all existing skills are optimised in the new licensed area, but again this is not tailored to innovation⁷⁴⁹.
- 8.8.24 As stated in chapter 2.9 of the provisional decision paper, the Authority considers there to be some overlap between this subparagraph 3.21(b)(iv) of the Criteria and subparagraph 3.21(b)(i) as evidence of a history of innovation is one way in which skills and experience may be demonstrated. firmus has therefore been given some credit with respect to subparagraph 3.21(b)(iv) on the basis of the examples of previous innovation described in section 11.5 of its ITT.

Final score for ITT criteria

- 8.8.25 The evidential burden is on the applicant to provide the Authority with information on which to base its assessment under paragraph 3.21 of the Criteria.
- 8.8.26 In respect of the matters listed in paragraph 3.21(a), firmus has provided evidence in relation to its ability to achieve innovation and technology transfer in relation to environmental sustainability and efficiency in the use of gas. However, the Authority would have expected to see more quantification of savings from past innovations, and a proposal, tailored to innovation, for the development of the network to more remote geographical areas.
- 8.8.27 In respect of the matters listed in 3.21(b) firmus has provided a number of examples of past innovation and has also demonstrated an ability to secure funding. However, the examples given for firmus' ability to secure funding have

⁷⁴⁸ firmus, OBP, pp. 18 – 20.

⁷⁴⁹ firmus, ITT, p. 23.

not been of funding to support innovation specifically. Also proposals to transfer innovation into Northern Ireland are limited.

- 8.8.28 On the basis of the above, the Authority confirms that its final decision is to award a score of 12 out of 20 to firmus' application in relation to innovation and technology transfer.

8.9. Resources Criteria

- 8.9.1 As explained in chapter 2 of the provisional decisions⁷⁵⁰, the Authority considered there to be a close connection between an applicant's score with respect to the Best Value Criterion and the assessment of whether it has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion. This is because of the substantial overlap in the information which is relevant to each.
- 8.9.2 The Authority therefore used its detailed analysis of the information provided with respect to the Best Value Criterion, as outlined above, as a basis for its assessment of whether firmus has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion.
- 8.9.3 Where an applicant has achieved scores which are consistently within the medium to high parts of the range in the assessment of its OBP it might be expected that its application would reveal a broad adequacy of resources for the purposes of the licence. This is the case even if the Authority's detailed analysis of that applicant's OBP found there to be some inadequacies in the information provided.
- 8.9.4 Where an applicant has been attributed one or more scores which are within the low part of the range in the assessment of its OBP – in other words, where it has achieved less than half of the marks that are available against at least one element of sub-criteria 3.17(a) to (c) – the Authority has considered carefully whether its application reveals an adequacy of its resources.

⁷⁵⁰ Chapter 2, paragraphs 2.7.23 to 2.7.29

- 8.9.5 firmus has been attributed scores which fall within the high range in respect of all of the elements of its OBP. Its application was supported by comprehensive, detailed and credible information, systematically addressed the relevant issues, and provided a clear and justified rationale.
- 8.9.6 In particular the Authority took into account that its proposed WACC of 5.57% fell within NERA's plausible range and was such that it would be able to raise the finance required to construct and operate the low pressure network while subject to a revenue control condition embodying the WACC.
- 8.9.7 The Authority's final conclusion is that firmus has demonstrated that it has the required resources to meet the obligations of the licence and thus has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion.

9.0 PNGL Low Pressure Connected

9.1. Introduction

9.1.1 This chapter:

- a. considers the application made by Phoenix Natural Gas Ltd (**PNGL**) for the low pressure licence, which is connected to its own application for the high pressure licence;
- b. the responses received to the consultation on the provisional decisions, as these relate to the connected low pressure application made by PNGL
- c. sets out the Authority's final conclusions as to whether PNGL has met each of the criteria other than the Best Value Criterion;
- d. sets out the Authority's final assessment of the marks to be awarded to PNGL in respect of the different elements of the Best Value Criterion;
- e. explains the reasons of the Authority for its final conclusions and marks.

9.1.2 In this chapter, the criteria have been addressed in the order in which they are set out in Chapter 2 of the provisional decisions, and the Authority has followed the approach to interpreting and applying the criteria that is set out in that chapter.

9.2. The Information Criterion

9.2.1 Both an electronic and a printed copy of the PNGL application were received by the Authority before the deadline of noon on 6 May 2014

9.2.2 Once the deadline had passed the application was opened and checked for completeness against a pre-prepared checklist. The application was assessed as being complete except in two respects:

- a. it was not clear from the application what information was being relied on by PNGL for the purposes of meeting the Adequate Resources Criterion;

and

- b. it was not clear from the application what information was being relied on by PNGL for the purposes of meeting the Financial Resources and Standing Criterion.
- 9.2.3 PNGL was informed of these apparent omissions and was given until noon on 14 May 2014 to provide the missing information. A response was received by the deadline and it was subsequently judged that this addressed the omission in full⁷⁵¹.
- 9.2.4 Having considered these facts, the Authority concluded that PNGL has provided all the information requested by the Authority, in such manner and by such times as was specified, and therefore meets the Information Criterion.

9.3. The Constitution Criterion

- 9.3.1 PNGL is a limited company with its registered office in Northern Ireland. PNGL's constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations⁷⁵².
- 9.3.2 Having considered this evidence, the Authority was satisfied that PNGL has demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.

9.4. The Fit and Proper Person Criterion

- 9.4.1 Evidence to demonstrate that PNGL is a fit and proper person was provided to the Authority in accordance with paragraphs 20 to 26 of Schedule 2 to the Application Regulations⁷⁵³ consisted of a signed statement by a senior officer of PNGL to the effect that PNGL had no information to disclose under any of those paragraphs.

⁷⁵¹ 2014-05-12 Reply to Information Request

⁷⁵² LP Connected Schedule 2 Part 1

⁷⁵³ Ibid

- 9.4.2 The Authority considered this evidence and noted that the information provided in respect of the criterion did not mention a threatened enforcement action by the Authority in relation to PNGL's existing gas conveyance licence. The Authority would have expected this to have been mentioned, and PNGL's failure to do so did not satisfy the requirements of the Application Regulations⁷⁵⁴
- 9.4.3 However, no conclusions have been reached by the Authority in relation to that threatened action, and the Authority did not in any event consider that the matter was sufficiently serious to call into question whether PNGL was a fit and proper person to be granted the licence. The Authority noted that PNGL has no other record of enforcement action being taken against it, or any other adverse factor of the type listed in the Application Regulations.
- 9.4.4 On the basis of the evidence provided to it, the Authority was therefore satisfied that PNGL meets the Fit and Proper Person Criterion.

9.5. Specific Criteria – Operational Business Plan 3.17(a)

Engagement with stakeholders

- 9.5.1 PNGL provides a list of stakeholder organisations with whom it currently engages together with a high level description of its current engagement activities, which include an annual program of ongoing engagement⁷⁵⁵. It also briefly describes the channels through which it communicates with stakeholders and cites social media and You Tube in this regard alongside direct meetings.
- 9.5.2 PNGL provides a list of stakeholder organisations with whom it will engage as part of the construction of the lower pressure system⁷⁵⁶. It notes that, in the course of constructing network, it already engages with some or all of the identified stakeholders on a regular basis and that this approach has proven

⁷⁵⁴ It did not, however, constitute a failure to meet the Information Criterion, since the relevant information had not been requested by the Authority.

⁷⁵⁵ PNGL, *Gas Network Extensions in Northern Ireland: Gas to the West ("G2W"): Phoenix Low Pressure Operational Business Plan*, p. 246.

⁷⁵⁶ *Ibid*, pp. 74 -75.

effective in its existing licensed area where it has developed a network and a market for natural gas over the last 17 years⁷⁵⁷.

9.5.3 Of the stakeholders it identifies, PNGL goes on to discuss its proposals for engagement with four in more detail - the Roads Service, local councils, the Department for Social Development and other utilities⁷⁵⁸. Again PNGL cites its current engagement activities with these stakeholders. In the context of roads, for example, this includes participation in the Northern Ireland Roads and Utilities Committee which meets quarterly to promote regional liaison and best practice, leading to improved cooperation between the parties and, at a local level, Divisional Roads and Utilities Committees⁷⁵⁹.

9.5.4 The Authority considers that PNGL has demonstrated that it has identified an appropriate range of stakeholders. Although it does not provide a detailed overarching stakeholder engagement plan PNGL does put forward proposals in respect of some of the major stakeholders which it identifies and the Authority particularly notes its existing relationships with those stakeholders and its experience of engagement in the context of low pressure networks in Northern Ireland.

Skills and experience

9.5.5 PNGL states that it has the skills and experience within its current operation to deliver a successful network, customer connections and wider natural gas industry⁷⁶⁰. It points to its development of the gas network in the greater Belfast area since 1996, an area which covers approximately 40% of the population of Northern Ireland⁷⁶¹. PNGL's network currently extends to over 3,000 kilometres of intermediate, medium and low pressure mains (7 to 4bar, 4bar to 800mb and 75mb to 25mbar respectively), which distribute natural gas throughout the existing licensed area. As at 31 December 2013, PNGL had made gas available (in accordance with the terms of its existing licence) to approximately 301,000

⁷⁵⁷ Ibid, p. 75.

⁷⁵⁸ Ibid, pp. 75 – 77.

⁷⁵⁹ Ibid, p. 75.

⁷⁶⁰ Ibid, p. 8.

⁷⁶¹ Ibid, p. 10.

properties within the existing licensed area, of which approximately 171,000 (57%) have been connected to the network⁷⁶².

9.5.6 PNGL states that it will draw on the strengths, knowledge and experience of existing Full-Time Equivalents (FTEs) including Senior Managers and Phoenix's Executive Directors who will develop the natural gas network in the new licensed area using the proven policies and procedures in place in the existing licensed area⁷⁶³. In section 2.3 of its OBP, PNGL provides a table which outlines details of the role, qualifications and length of service in current role of the commercial operations personnel who are responsible for management, design, planning and supervision of live gas and construction activities in the existing licensed area⁷⁶⁴.

9.5.7 A subsequent table provides details of the roles which will be needed in respect of the new licenced area and it is stated that efficiencies can be achieved by consolidating some of the functions within PNGL in respect of the existing and new licensed areas⁷⁶⁵. It is stated that this will ensure that the distribution business within the new licenced area benefits from the knowledge and experience of existing FTEs including Senior Managers and directors⁷⁶⁶.

9.5.8 The OBP states that a marginal increase of 6.25 internal FTEs from years one to five, growing to 6.90 FTEs in year ten, will be required to manage these consolidated functions which it has identified. An additional assistant quality surveyor and an additional planner will also be required in years one to ten to support the FTEs working within PNGL thereby consolidating these activities across the existing and the new licensed areas⁷⁶⁷.

9.5.9 It is stated that on award of the licence PNGL will immediately begin the recruitment of four engineers. PNGL states that it has considerable experience in training and developing Engineers and proposes to utilise the new engineers, alongside the existing experienced engineers, to carry out the detailed design of

⁷⁶² Ibid, pp. 10 – 11.

⁷⁶³ Ibid, p. 11.

⁷⁶⁴ Ibid, p. 40 – 41.

⁷⁶⁵ Ibid, pp. 42 – 43.

⁷⁶⁶ Ibid, p. 43.

⁷⁶⁷ Ibid, p. 44.

- the low pressure network for the new licensed area. It also states that an experienced engineer will be appointed as Network Operations Manager.
- 9.5.10 PNGL's proposed arrangements for recruitment of the necessary roles and its current recruitment process is detailed in section 3.2⁷⁶⁸.
- 9.5.11 With respect to external resources, although a contract is not in place for construction of the network, the Authority notes that PNGL has experience in securing and managing such contract as illustrated by its contract with McNicholas which came to an end in July 2014, for example. PNGL also states that contracts for other services such as emergency response, and installation and disconnection of meters can be provided under existing contracts⁷⁶⁹.
- 9.5.12 The Authority considers that PNGL has provided detailed information which illustrates that many of the staff with the skills and experience required to undertake the activities required by the licence are already in place within the organisation and that it has extensive experience of similar activities.
- 9.5.13 In relation to external skills and experience, the Authority notes that some contracts are already in place which will be capable of extension to cover the new licensed area and where existing contracts are not in place PNGL has relevant experience in sourcing and managing appropriate contracts. Although the Authority cannot directly assess either the nature of the contracts which PNGL has in place, or the skills and experience of the persons with whom it has such arrangements, the experience upon which PNGL can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate.

The Management of risk

- 9.5.14 In section 4.1 of its OBP PNGL provides (i) an identification and quantification of risk issues, including significant asset risk issues, (ii) a description of the policy

⁷⁶⁸ Ibid, pp. 57 – 61.

⁷⁶⁹ Ibid, pp. 17 and 206.

- and processes to identify and manage risk issues, and (iii) a description of the procedures to mitigate risk and monitor actions to completion⁷⁷⁰.
- 9.5.15 PNGL goes on to provide detailed information on its Corporate and Operational Risk Registers, risk assessment processes, the work of its Risk Review Committee and Network Safety Group and the role of audit in providing the Directors with assurance that risks identified are being appropriately managed⁷⁷¹. PNGL states that it is envisaged that its current processes in regard to risk identification and management will be applied to its activities under the licence⁷⁷².
- 9.5.16 The OBP provides some evidence that PNGL has identified specific risks in relation to the Gas to the West project. For example, PNGL cites the construction of feeders in advance of the availability of gas from the high pressure pipelines to facilitate gas to consumers as early as possible which may result in 'the possibility of a third party contractor damaging the gas main and, as there is no actual gas leaking, failing to notify the gas company of the damage'⁷⁷³. To mitigate this risk, PNGL states that it will then leave the mains charged with a small amount of air, at a pressure that minimises the risk posed by the stored energy in the event of a sudden release⁷⁷⁴.
- 9.5.17 Section 5.7 of the OBP provides proposals to identify and manage asset risk issues in relation to the new network. It states that PNGL's existing Network Safety Group, Risk Review Committee and QUEST will be used in the same way to identify and manage risk issues associated with the new distribution business under the licence. Additional measures in relation to risk are also identified including a risk assessment process, safety alert process and safety tour inspections⁷⁷⁵.
- 9.5.18 The Authority considers that PNGL has demonstrated that it has a robust policy for the identification and management of risks and that there is evidence that this

⁷⁷⁰ Ibid, pp. 102 – 113.

⁷⁷¹ Ibid. pp. 103 – 109.

⁷⁷² Ibid, pp. 103 and 172.

⁷⁷³ Ibid, p. 57.

⁷⁷⁴ Ibid, p. 57.

⁷⁷⁵ Ibid, pp. 172 – 173.

approach has been applied to identify a limited number of specific risks relating to the Gas to the West project and their mitigation.

9.5.19 This view is supported by the report from Rune⁷⁷⁶.

Tendering arrangements

9.5.20 At section 6.1 of its OBP, PNGL sets out high level details of the policies and procedures which it uses to ensure compliance with the requirements of EU procurement law and financial thresholds for advertisement in the EU Journal are specified⁷⁷⁷.

9.5.21 The submission also sets out at a high level how procurement within PNGL is currently managed and demonstrates an understanding of best practice tendering⁷⁷⁸. PNGL's financial approval procedures and levels of Authority are also explained. It is stated that the model developed within its existing licenced area will be replicated for procurement within the new licenced area⁷⁷⁹.

9.5.22 Section 6.2 of the OBP describes in general terms the proposed arrangements for procurement of the essential materials required for construction and operation of the network and are summarised as follows - 'With regards to procurement of materials, the necessary planning arrangements would largely centre on the development of an overall project delivery strategy of which the contract strategies for the various works, supplies and services would be determined'⁷⁸⁰.

9.5.23 PNGL provides proposals for the procurement of materials during the mobilisation phase in section 3.6. It states that materials to be incorporated into the gas network construction (gas engineering and civil engineering related) will be procured as part of the main construction contract. PNGL states that it has procured and awarded a number of similar construction contracts in the past and

⁷⁷⁶ RUNE Associates, op cit, p. 3.

⁷⁷⁷ Ibid, p. 203.

⁷⁷⁸ Ibid, pp. 204 – 205.

⁷⁷⁹ Ibid, p. 207.

⁷⁸⁰ Ibid, p. 206.

as part of its overall contract strategy it has reviewed the merits of separate contracts for both materials supply and network construction⁷⁸¹.

9.5.24 The Authority notes that the report from Rune indicates that some of the proposed arrangements and processes outlined in the OBP are addressed at a high level. Rune does, however, note that PNGL intends to implement processes similar to those used in the current licensed area and that these include competitive tendering to achieve best value⁷⁸².

9.5.25 The Authority considers that PNGL has provided information regarding its proposals as to the use of tendering arrangements and that its tendering arrangements are robust and in line with best practice. Although the proposals lack detail in some respects, the Authority notes that they will build on arrangements which PNGL has successfully used for procurement in relation to its current low pressure network.

Final score for criterion 3.17(a)

9.5.26 PNGL has provided a comprehensive statement, backed by appropriate evidence, of how it will undertake the activities which would be the subject of obligations set out in the licence for which it has applied.

9.5.27 The Authority particularly notes PNGL's proposals for engagement with stakeholders and information on its existing relationships. The Authority also notes PNGL's previous experience in relation to the construction and operation of low pressure networks and that where skills and experience need to be sourced externally contracts are in place or can be extended where required. Proposals for the management of risk and tendering arrangements were also robust.

9.5.28 On the basis of the above the Authority confirms that its final decision is to award 16 marks out of 20 to PNGL in relation to subparagraph 3.17(a).

⁷⁸¹ Ibid, p 88.

⁷⁸² RUNE Associates, op cit, p.7.

9.6. Specific Criteria – Operational Business Plan 3.17(b)

9.6.1 The Application Information Pack asked applicants to supply costs for WACC, Operating Expenditure and Mobilisation Costs and the Authority considers PNG's application submission of costs in this section. For the purposes of this paper the Authority dealt with the costs under two headings – WACC and Operating Expenditure. The Authority's views on Mobilisation costs are included under the Operating Expenditure heading. The Authority set out in the Application Information Pack⁷⁸³ greater detail on what these costs might include.

Description of the derivation of cost data

Weighted Average Cost of Capital

9.6.2 NERA was requested to produce a report on what it would expect to see in a well-evidenced WACC submission. The Authority substantially agreed with the assessment reflected in that report. It follows the Authority would have expected to see:

- a. The cost of debt set out using: (i) a benchmark gilt yield (to reflect a risk free rate) plus evidence on corporate debt spreads with market evidence provided for both; and/or (ii) direct evidence of corporate debt yields with market evidence provided. For this purpose, references to corporate debt spreads/yields should reflect companies with similar risk profiles, issuance costs should be included in the cost of debt and the treatment of inflation should be clearly explained in the derivation.
- b. The cost of equity set out using CAPM and incorporating the risk free rate, equity risk premium and beta with relevant evidence provided to justify each component.
- c. The proposed gearing including a discussion on the how this interacts with the risks of the project, the proposed credit rating and the cost of debt.

9.6.3 The application is based on a standard debt / equity capital structure and includes proposals for both debt and equity costs applying the CAPM model to

⁷⁸³ Applicant Information Pack Annex 8

propose a WACC of 5.7% in Years 1 to 5 and a final figure of 5.35% in Years 6 to 10.⁷⁸⁴

- 9.6.4 The Authority considers that the description of how the WACC figures were derived was minimal and provided no detail as to how the values for the individual components were built up.
- 9.6.5 The application notes that consideration has been given to recent regulatory precedents on WACC but that these may not be appropriate for a number of reasons including the specific circumstances of this project⁷⁸⁵. There is also a discussion of the various risks that have been considered in arriving at the WACC figure including volume risk, construction risk and regulatory risk in NI⁷⁸⁶.
- 9.6.6 For the cost of debt it is stated that the application is based on discussions with a number of banks as to indicative terms on which financing of this project might be provided⁷⁸⁷.
- 9.6.7 For the cost of equity there is a mention that the cost incorporates the risk of the cost of debt changing between the application date and when the debt is raised⁷⁸⁸. Other than the general risks mentioned above there is no explicit discussion of the cost of equity.
- 9.6.8 The Authority notes that there is no information provided on the risk free rate, debt premium, equity risk premium or betas. This falls far short of what the Authority would expect in a well evidenced application.
- 9.6.9 There is very limited evidence presented in support of the assertions made about the likely value of any of the components which contribute to a WACC figure⁷⁸⁹. For example the identity of the banks with which discussions were held is not specifically referenced nor were the indicative terms being offered. The Authority does not consider this to be either reliable or robust evidence.

Operating Expenditure

⁷⁸⁴ LPOBP – Phoenix Low Pressure Operational Business Plan – Chapter 10

⁷⁸⁵ Ibid LPOBP – Phoenix Low Pressure Operational Business Plan – Chapter 10

⁷⁸⁶ Ibid LPOBP – Phoenix Low Pressure Operational Business Plan – Chapter 10

⁷⁸⁷ Ibid LPOBP – Phoenix Low Pressure Operational Business Plan – Chapter 10

⁷⁸⁸ Ibid LPOBP – Phoenix Low Pressure Operational Business Plan – Chapter 10

⁷⁸⁹ LPOBP – Phoenix Low Pressure Operational Business Plan – Chapter 10

- 9.6.10 Mobilisation – The application includes a clear table setting out mobilisation costs split down into its major components.⁷⁹⁰ The activities funded by each of these cost lines is more fully explained elsewhere in the text⁷⁹¹ with a tabular explanation provided in an excel spreadsheet⁷⁹². This taken together provides a mostly comprehensive description of how the Mobilisation cost was derived although some areas e.g. marketing and advertising have limited discussion on what the actual costs proposed are made up of. The Authority is not clear what risks are covered by business insurance in the mobilisation period and notes that IT mobilisation costs do not seem to be detailed in the OBP.
- 9.6.11 Operating Expenditure - A detailed explanation of how the costs are built up is provided in the application⁷⁹³ and this is translated into excel worksheets which are then linked to the Data Input Workbook itself. This permits an audit trail between the Data Input Workbook and the OBP. The Authority also notes that one large cost area, manpower, has a significant level of detail provided⁷⁹⁴ which covers all aspects of the costs that build up the final figure⁷⁹⁵.
- 9.6.12 There are also inconsistencies between the OBP and the Data Input Workbook. For example the OBP states that by year ten there will be 7.3 FTE's⁷⁹⁶ but yet in the Data Input Workbook manpower costs in year 10 are based on 8.71 FTE's⁷⁹⁷. This error appears to apply for all manpower FTE numbers from years 6-10 as there is a discrepancy between the Data Input Workbook costs in those years and the figures provided by Table 1. This error is compounded as FTE's are used as a cost driver in many of the other costs.
- 9.6.13 The Authority notes that there appears to be an error in the calculation of Marketing, Advertising and PR cost. While the OBP states⁷⁹⁸ that the drivers include the cumulative number of connections in a given year the spreadsheet⁷⁹⁹ has the same figure (20,117) from years 1-10. Clearly the cumulative number of

⁷⁹⁰ LPOBP – Phoenix Low Pressure Operational Business Plan – section 3.4

⁷⁹¹ LPOBP – Phoenix Low Pressure Operational Business Plan – section 3.3

⁷⁹² LPDIW – Phoenix Low Pressure Data Input Workbook - Phoenix Assumptions <<<<

⁷⁹³ LPOBP – Phoenix Low Pressure Operational Business Plan – section 8.3

⁷⁹⁴ LPOBP – Phoenix Low Pressure Operational Business Plan – p21-28

⁷⁹⁵ LPOBP – Phoenix Low Pressure Operational Business Plan – p255-256

⁷⁹⁶ LPOBP – Phoenix Low Pressure Operational Business Plan – page 256

⁷⁹⁷ LPDIW – Phoenix Low Pressure Data Input Workbook - Manpower cell M8 + cell M16

⁷⁹⁸ LPOBP – Phoenix Low Pressure Operational Business Plan – page 251

⁷⁹⁹ LPDIW – Phoenix Low Pressure Data Input Workbook - AMPR cell D22-cell M22

connections should be rising which suggests there is an error. The error suggests the accuracy of the information provided is not complete.

Identification and application of cost drivers

Operating Expenditure

- 9.6.14 For some major mobilisation cost items no figures were provided on the build up of costs e.g. Advertising Marketing & PR and Professional and Legal Fees. In contrast there was more cost driver detail on minor costs items such as billing, entertainment, travel and subsistence.⁸⁰⁰
- 9.6.15 Operating Expenditure - Cost drivers were identified for many of the individual cost lines with these being linked back to GD14 price control allowances. These have then been applied in a coherent way to and are mostly set out in the Data Input Workbook which provides good clarity.
- 9.6.16 However the Authority does note on some occasions data has been simply hard coded into these worksheets where it would have been more helpful if cost drivers had been provided e.g. Emergency First Response.⁸⁰¹ While the Authority notes there is some discussion of how these costs are built up in the OBP⁸⁰² there are no detailed numbers provided in the spreadsheet.

Robustness of assumptions

- 9.6.17 The Authority identified and considered a number of assumptions that appeared to have been made by PNGL when deriving the data contained in its Data Input Workbook.

The Value of the WACC

- 9.6.18 First, the Authority took it to be implicit throughout the application that PNGL had assumed it will be able to carry on the licensed activities under the low pressure licence, and to do so consistently with its obligations under that licence, on the basis of the proposed WACC. That is to say, there was an implicit assumption that PNGL will be able to raise the finance required to construct and operate the

⁸⁰⁰ LPDIW – Phoenix Low Pressure Data Input Workbook - see relevant sheets

⁸⁰¹ LPDIW – Phoenix Low Pressure Data Input Workbook - Emergencies First Response

⁸⁰² LPOBP – Phoenix Low Pressure Operational Business Plan – page 254

low pressure network while subject to a revenue control condition embodying its proposed WACC.

- 9.6.19 For the purpose of testing this assumption, the Authority considered whether the proposed WACC fell within the range of what might reasonably be expected in the context of the G2W project. To do this, it considered the market cost of debt and equity based on advice received from NERA, which took into account in its report such costs as referenced in recent regulatory decisions⁸⁰³. NERA advised on what it considered to be the 'plausible range' within which it would expect any WACC for this project to lie. The Authority relied upon the advice contained in the report as establishing a range against which to test PNGL's assumption
- 9.6.20 NERA established a 'plausible range' in respect of a corporate finance structure of between 3.5% and 6.2%, and PNGL's proposed WACC was 5.7% in years 1 to 5 and 5.35% in years 6 to 10.
- 9.6.21 The Authority noted that the proposed PNGL WACC lay at the high end of, but fell within, the range identified by NERA.
- 9.6.22 In addition PNGL supported its application by referencing letters of comfort from a number of financial institutions and equity investors,⁸⁰⁴ and in addition a history of financing similar projects⁸⁰⁵.
- 9.6.23 The Authority considered that these letters of comfort did not represent a firm commitment by the relevant banks to provide the required financing. The letters note that any future funding commitment would be conditional on several factors, including credit market conditions, satisfactory due diligence, the final form of the legal documents and the licence, and other factors. They are not legally binding, nor do they purport to be so. Moreover, the Authority did not understand them to commit the banks in any sense that might properly be regarded (even allowing that they fall short of a legal obligation) as entailing a 'firm' commitment.
- 9.6.24 In order to clarify whether its understanding of the status and effect of the comfort letters was correct, the Authority sought advice from both NERA⁸⁰⁶ and

⁸⁰³ NERA, Gas to the West, A report for the Utility Regulator

⁸⁰⁴ Email 2014=05-12 PNGL reply to information request

⁸⁰⁵ S2.8 Financial Resources and Standing LP

⁸⁰⁶ NERA, Gas to the West, A report for the Utility Regulator p.21.

the Strategic Investment Board⁸⁰⁷. Each of them confirmed the Authority's initial view that there was significant conditionality attached to the letters, including in relation to due diligence and internal bank clearances. The Strategic Investment Board noted that while the letters 'certainly indicate willingness from the funders concerned to participate in the project', it did 'not believe that the letters can be relied upon as evidence'. The Authority accepted this advice.

- 9.6.25 This did not entail any conclusion that the letters of comfort were inappropriate. The Authority recognised that funding commitments are likely to be contingent on, and related to the conditions of, the licence as granted; in particular on the terms of the price control which determine the value of the income stream that can be generated by the licence holder.
- 9.6.26 Moreover, the Authority did not consider that there was any ground for materially distinguishing between the weightings between applicants. It accepted the advice of the Strategic Investment Board in this respect.
- 9.6.27 However, while accepting that a comfort letter indicates a willingness on the part of the relevant funder to participate in the project, the Authority considers that no material degree of weight can be attached to such letters for the purposes of demonstrating PNG's cost of debt.
- 9.6.28 Having regard to its own expertise, the Authority considered that the proposed WACC was high and therefore reflective of a cost of debt and equity that would attract investors. Given that the WACC also lay within NERA's plausible range, and given the historical evidence presented, the Authority had no concerns about the ability of PNG to finance its activities under the low pressure licence on the basis of the proposed WACC.
- 9.6.29 Therefore the Authority concluded that the assumption that PNG would be able to obtain financing to carry on the licensed activities on the basis of the proposed WACC was robust.

Asset Beta

⁸⁰⁷ SIB – Letter to Uregni (2).

9.6.30 The application set out a number of assumptions about the level of risk which an investor in the project would face however little evidence was presented in support of these assumptions and no value was placed on the impact they would have on the various components of WACC. For example in the discussion on volume risk it is stated that in preparing the application scenario an assessment has been carried out to understand the impact on required returns⁸⁰⁸. None of this analysis however was presented as evidence in the application.

9.6.31 The application states that the regulatory environment in Northern Ireland results in a higher level of risk than that which exists in Great Britain⁸⁰⁹. No empirical evidence on debt or equity costs is presented in support of this assertion. Our view as confirmed by First Economics⁸¹⁰ is that the assumption that there is a Northern Ireland risk premium on the WACC is erroneous. This assumption has also been rejected by the Competition Commission who included the following comments in its final determination:

- a. ‘...13.64 We accept that there appears to be a premium in the yield on NIE’s debt compared with comparable instruments issued by other electricity distribution companies in the UK.
- b. ...13.66 We did not rule out the possibility that the premium, which was at its greatest in 2011 and 2012, was in part caused by market concern about ESB, which was alleviated following ESB’s successful refinancing in the latter part of the calendar year 2012.
- c. ...13.111 Importantly, the observed premium on NIE bonds has decreased significantly since January 2013 (see Figure 13.2) and does not now appear significantly higher than Frontier’s highest estimate of a liquidity premium. It appears to us that the yield on NIE’s bonds is no longer indicative of any additional risk perceived by bondholders compared with similar companies elsewhere in the UK’.

9.6.32 The Authority therefore finds the assumptions of such a premium in not robust.

⁸⁰⁸ Ibid

⁸⁰⁹ Ibid

⁸¹⁰ First Economics

9.6.33 The applicant also assumes that WACC should be higher because of construction risk and references other regulatory decisions linked to construction risk⁸¹¹. However no evidence is provided as to the value of any such premium nor to the relevance of the referenced regulatory decisions to a regulated energy utility. In addition the Authority note there is no reference made to calculations which other regulators have used in determining how companies with different levels of asset value relative to totex spend (construction risk) might require different beta figures e.g. Ofgem RIIO - GD1.

Operating Expenditure

9.6.34 Not all the assumptions set out in the OBP appear to be carried through on a consistent basis into the calculation of Operating Costs. For instance it is stated that costs associated with capital formation and the owner occupiers connection incentive are excluded from cost estimates in the Data Input Workbook⁸¹². However within the Data Input Workbook itself some costs are net of these costs which is correct, for example AM+ PR, some costs are gross which is incorrect, for example Office IT and HR⁸¹³, while for other it is not obvious which approach has been adopted, for example Professional and Legal.

9.6.35 The application assumes that there will be a reduction in distribution charges to incentivise I&C connections⁸¹⁴. While the Authority recognises that this has been done previously there is limited discussion on the implications of this and the Authority would have expected some further analysis including quantification of the incentive and the associated risks, including the risk of higher future charges as a result of the reduction in distribution charges in the short term.

Evidence verifiable from previous experience

9.6.36 Northern Ireland specific experience has been drawn upon in the identification and application of cost drivers when forecasting future Operating Expenditure

⁸¹¹ LPOBP – Phoenix Low Pressure Operational Business Plan – page 282

⁸¹² LPOBP – Phoenix Low Pressure Operational Business Plan – page 250

⁸¹³ LPDIW – Phoenix Low Pressure Data Input Workbook.

⁸¹⁴ LPOBP – Phoenix Low Pressure Operational Business Plan – page 251

levels. The Authority regards the reference to this experience as being appropriate.

Identification and quantification of risk

Weighted Average Cost of Capital

- 9.6.37 The application identifies the risk of debt costs changing between the date of the application and the actual debt being introduced⁸¹⁵. The application states this is included in the equity return but no figures are provided.

Operating Expenditure

- 9.6.38 While the OBP does include a section on the identification and quantification of risk⁸¹⁶ the Authority considers this not to have dealt with the issue comprehensively. While a number of risks have been identified there is no evidence that the probability of any of these events occurring has been estimated. Nor is there any quantification of the impact on outputs that might be expected. This is in spite of the application referencing its approach to risk which is stated as including a review of probability and impact.⁸¹⁷
- 9.6.39 The Authority also notes that there is some discussion on mobilisation risks⁸¹⁸ but there is limited discussion on the risks in respect of costs.

Efficiency improvement plan

- 9.6.40 We consider the efficiency improvement plan provided⁸¹⁹ to be of reasonable quality. The plan identifies four main methods to improve efficiency. These being:
- 9.6.41 Business processes improvements where suggestions include, actions to reduce non-emergency calls to the emergency call centre;
- 9.6.42 Innovation where reference is only made to past developments such as Alliance Contracting, open book project management and the up skilling of staff. A link is

⁸¹⁵ LPOBP – Phoenix Low Pressure Operational Business Plan – page 282

⁸¹⁶ LPOBP – Phoenix Low Pressure Operational Business Plan – p264

⁸¹⁷ LPOBP – Phoenix Low Pressure Operational Business Plan – p103-104

⁸¹⁸ LPOBP – Phoenix Low Pressure Operational Business Plan – page 100

⁸¹⁹ LPOBP – Phoenix Low Pressure Operational Business Plan – Section 8.4

made to the Innovation and Technology Transfer submission which the Authority also considers to be limited and only moderately evidenced.⁸²⁰

- 9.6.43 Benchmarking where existing Northern Ireland regulatory processes are referenced;
- 9.6.44 Group Development Forums that appear to be little more than standard internal processes to deliver against a business plan.
- 9.6.45 The Authority also notes that the application refers to efficiency improvements from maintaining unit costs across years one to ten. The Authority does not view the proposition to retain costs in real terms as constituting an efficiency improvement.

Final score for criterion 3.17(b)

Weighted Average Cost of Capital

- 9.6.46 The evidence presented in this application in support of the WACC was weak. The application failed to provide sufficient evidence to determine whether it was based on either reliable evidence or robust analysis.
- 9.6.47 Overall the Authority finds that in relation to the Weighted Average Cost of Capital the application to be of very poor quality when judged against sub criterion 3.17b.

Operating Expenditure

- 9.6.48 Overall the Authority finds the explanation of the ongoing Operating Expenditure to be of a moderate quality. The discussion on most of the costs was detailed and the Excel worksheets provide a clear audit trail as to how the costs in the Data Input Workbook were derived and how these link back to the OBP.
- 9.6.49 However the Authority notes the use of hard coded data and some errors detracts from the overall quality.

Final Conclusion

⁸²⁰ Chapter 6.8 of this consultation.

- 9.6.50 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the PNGL application should attract a medium score, and its final decision is to award 10 out of 20 marks.
- 9.6.51 The Authority compared this mark with those provisionally awarded to the other low pressure applicants to satisfy itself that it continued to be appropriate when benchmarked against them.
- 9.6.52 When compared with the other applications, the Authority considered that the PNGL application was poorer than firmus but better than SGN in relation to Operating Expenditure. While a spreadsheet had been included a number of errors were identified and it was not always clear how data was arrived at. The omission of such a spreadsheet from the SGN application prevented the thorough scrutiny of data that was possible with the other applications. On the other hand the application in relation to WACC fell very much behind that of the other applications in that it provided very little evidence in support of the build up of WACC.

9.7. Specific Criteria – Operational Business Plan 3.17(c)

The experience of the applicant and others on whom it intends to rely in relation to network construction

- 9.7.1 As discussed above, since 1996 PNGL has developed the low pressure network in the greater Belfast area, which covers approximately 40% of the population of Northern Ireland⁸²¹. PNGL's existing network currently extends to over 3,000km of intermediate, medium and low pressure mains (7 to 4bar, 4bar to 800mb and 75mb to 25mbar respectively), which distribute natural gas throughout the existing licensed area.
- 9.7.2 PNGL states that it will draw on the strengths, knowledge and experience of existing Full-Time Equivalents (FTEs) including Senior Managers and Executive Directors who will develop the natural gas network in the new licensed area using the proven policies and procedures in place in the existing licensed

⁸²¹ Ibid. p. 10.

area⁸²². In section 2.3 of its OBP, PNGL provides a table which outlines details of the role, qualifications and length of service in current role of the commercial operations personnel who are responsible for management, design, planning and supervision of live gas and construction activities in the existing licensed area⁸²³.

9.7.3 With respect to external resources, although a contract is not in place for construction of the network, the Authority notes that PNGL has experience in securing and managing such contracts, as illustrated by its contract with McNicholas which came to an end in July 2014. PNGL also states that other services such as emergency response, and installation and disconnection of meters can be provided under existing contracts⁸²⁴.

9.7.4 PNGL has provided detailed information which illustrates that many of the staff with the skills and experience required to undertake the activities required by the licence are already in place within the organisation and that it has extensive experience of similar activities.

9.7.5 In relation to external skills and experience, the Authority notes that some contracts are already in place which will be capable of extension to cover the new licensed area. Where existing contracts are not in place PNGL has relevant experience in sourcing and managing appropriate contracts. Although the Authority cannot directly assess either the nature of the contracts which PNGL has in place, or the skills and experience of the persons with whom it has such arrangements, the experience upon which PNGL can draw in relation to the construction of similar networks is sufficient indication that such arrangements can be viewed as appropriate.

9.7.6 This view is supported by the report from Rune⁸²⁵.

⁸²² Ibid, p. 11.

⁸²³ Ibid, p. 40 – 41.

⁸²⁴ Ibid, pp. 17 and 206.

⁸²⁵ Rune Associates, pp. 10 – 11.

The experience of the applicant and others on whom it intends to rely in relation to network operation

- 9.7.7 PNGL currently operates the low pressure network in its existing licensed area as described above. The Authority notes, and places weight on, the fact that PNGL is the only distribution network operator in Northern Ireland which owns and operates its own control room and that this will be utilised for the new licensed area⁸²⁶.
- 9.7.8 The OBP also indicates that the existing PNGL network has telemetry installed in all of its district Pressure Reduction Stations (PRSs). This telemetry links into a central system in the control room and allows PNGL to monitor each district PRS's operational status, performance and security status at all times⁸²⁷.
- 9.7.9 PNGL also highlights that since 1996 it has fulfilled the role of the Northern Ireland Network Emergency Coordinator (NINEC) and is therefore responsible for preparing, updating and implementing the NINEC Safety Case⁸²⁸. It states that through this role it has built up a sound technical knowledge and understanding of the overall Northern Ireland natural gas supply system, its structures and operating capabilities. PNGL states it will use the skills and experience of its key members of staff (such as its Health Safety and Environment Manager) in preparing a Safety Case for the new licensed area⁸²⁹.
- 9.7.10 PNGL also points to its experience in delivering a competitive retail market through, for example, providing significant input into the development of the Gas Suppliers' Supply Meter Point Agreement⁸³⁰. PNGL also states that it has the necessary supporting systems to support the network code and retail competition⁸³¹.
- 9.7.11 The OBP provides an assessment of whether these existing processes and systems could be utilised for the new licensed area⁸³² and concludes that key systems such as customer switching can be utilised in the new licensed area.

⁸²⁶ PNGL, op cit, p. 157.

⁸²⁷ Ibid.

⁸²⁸ Ibid, p. 134.

⁸²⁹ Ibid,.

⁸³⁰ Ibid, p. 144.

⁸³¹ Ibid, p. 147.

⁸³² Ibid, pp. 148 – 155.

PNGL indicates that its existing Transportation Services Team will manage the network code requirements and deliver a competitive retail market in the new licensed area⁸³³.

9.7.12 In relation to external skills and experience, PNGL relies on PES for emergency response on the network and on National Grid to handle emergency calls from the public to the Northern Ireland Emergency Gas Number. The OBP indicates that the existing emergency response framework will be extended to cover the new licensed area⁸³⁴.

9.7.13 The Authority considers that PNGL has demonstrated that in relation to the operation of the network it has appropriate skills and experience within the company based on the operation of a similar network in Northern Ireland.

9.7.14 This view is supported by the report from Rune⁸³⁵.

Securing, mobilisation and management of resources

9.7.15 PNGL indicates that its proposals in respect of the new network are based on utilising and extending its existing arrangements for managing all aspects of its existing licensed area business to include the new licensed area wherever possible.

9.7.16 In relation to the mobilisation of internal resources necessary to construct a low pressure network, PNGL states that it will ensure that the new distribution business benefits from the knowledge and experience of existing staff including Senior Managers and the Directors⁸³⁶. PNGL also states that it will transfer experienced engineers from its core business while it undertakes further recruitment and that overall responsibility for the engineers on the project will be assigned to a Senior Manager within the existing Commercial Operations department, who in turn will report to the Commercial Operations Director.⁸³⁷

9.7.17 In section 2.2 of the OBP information is provided in relation to the total additional internal manpower resources, categorised by role, required for years 1 to 5 and

⁸³³ Ibid, p. 155.

⁸³⁴ Ibid, p. 176.

⁸³⁵ Rune Associates, p. 13.

⁸³⁶ PNGL, op cit, p. 19.

⁸³⁷ Ibid, p. 53.

6 to 10 of the project⁸³⁸. Section 2.4 provides information in relation to PNGL's arrangements for deployment into the new licensed area⁸³⁹.

- 9.7.18 Section 2.3.1 describes in general terms the PNGL's arrangements for competence management and includes details of the professional and academic qualifications and experience associated with all levels of key personnel⁸⁴⁰. The information covers personnel responsible for management, design, planning and supervision of live gas and construction activities in both the existing and new licensed areas.
- 9.7.19 As discussed above PNGL has provided a detailed assessment of whether its existing processes and systems in relation to the network code and retail competition process can be utilised for the new licensed area⁸⁴¹.
- 9.7.20 Section 3.5 refers to the IT systems that Phoenix has developed to support management of the existing licensed area business and proposes to substantially utilise for the new network. It also includes specific reference to asset management and work issue processes and arrangements to procure required GIS related information systems are described.
- 9.7.21 In relation to the mobilisation of other external resources, as noted above the contract with McNicholas for construction will need to be retendered. However, other existing contracts could be used for the new licensed area.
- 9.7.22 PNGL state that under EU Procurement Regulations, Phoenix Energy Services (PES) is regarded as an 'Affiliated Undertaking', therefore PNGL may directly award a contract to PES⁸⁴². PES currently provides services such as installation of gas meters and emergency response. PNGL also envisages that gas metering equipment during the mobilisation phase could be delivered through existing PNGL contracts⁸⁴³.
- 9.7.23 PNGL proposes to put in place a work plan for communicating with gas suppliers during the mobilisation phase and to identify a party willing to undertake the

⁸³⁸ Ibid, p. 22.

⁸³⁹ Ibid, p. 47.

⁸⁴⁰ Ibid, pp. 34 – 39.

⁸⁴¹ Ibid, pp. 148 – 155.

⁸⁴² Ibid, p. 208.

⁸⁴³ Ibid, p. 206.

commissioning supplier role in order to provide a potential customer with support to switch to natural gas in a cost effective way⁸⁴⁴.

9.7.24 The Authority notes the detailed information that PNGL has provided in relation to adapting the existing emergency framework and procedures to the new licensed area and which will be undertaken during mobilisation.⁸⁴⁵

9.7.25 The Authority considers that PNGL has provided detailed proposals on securing, mobilisation, and management of, the internal and external resources necessary to construct the low pressure network. The Authority particularly notes PNGL's previous experience in this regard.

9.7.26 This view is supported by the report from Rune⁸⁴⁶.

The experience of the applicant and others on whom it intends to rely in relation to achieving connections

9.7.27 In its OBP, PNGL points to a strong track record of achieving connections in its existing licensed area which was not previously supplied with gas. PNGL states that as at 31 December 2013, it had made gas available to approximately 301,000 properties within its existing licensed area, of which approximately 171,000 (57%) had been connected to the network⁸⁴⁷. PNGL also point to the fact that the pattern of connections, including a focus on owner occupiers, to be applied in the G2W area is consistent with the model it applies in the Belfast area.⁸⁴⁸

9.7.28 As the Authority would expect, PNGL recognises that the development of a network of installer and retailers is crucial to future connection growth⁸⁴⁹. PNGL points to its existing relationships with installers and, in particular, states that it has a relationship with 300 (around 60%) of the Gas Safe registered installation

⁸⁴⁴ Ibid, p. 145.

⁸⁴⁵ Ibid, p. 184.

⁸⁴⁶ Rune Associates, pp. 17 and 22.

⁸⁴⁷ Ibid, p. 219.

⁸⁴⁸

⁸⁴⁹ Ibid, p. 11.

companies in Northern Ireland who each feature on the Phoenix Register of Listed Installation Companies⁸⁵⁰.

9.7.29 The Authority notes the risk identified by PNGL that the availability of experienced and skilled Gas Safe registered installation companies operating in the new licensed area is limited and PNGL's view that upskilling this sector will be important to the roll-out of natural gas⁸⁵¹.

9.7.30 PNGL states that it works closely with gas suppliers, including providing gas suppliers with a training programme to ensure that they are fully aware of their network code obligations and the processes PNGL has in place to meet these obligations⁸⁵².

9.7.31 PNGL also points to the other customer and stakeholder relationships it has developed as part of the process of generating connections in its existing licensed area with, for example, local councils⁸⁵³ and road authorities⁸⁵⁴.

9.7.32 The OBP makes reference to the importance of the existing PNGL brand and how this will be built upon in the new licensed area as the network expands⁸⁵⁵.

9.7.33 In sections 7.1 and 7.2 of its OBP PNGL sets out a detailed description of its proposals to maximise connections in the new licensed area⁸⁵⁶. This includes an explanation of how PNGL will meet the pattern of connections set out in the Fingleton MacAdam development plan as well as outlining plans to maximise the number of premises connected to the network through engagement with businesses, social landlords and potential customers.

9.7.34 The Authority considers that PNGL has provided detailed information in relation to its experience of achieving connections in an area not previously supplied with gas through a gas network and, drawing on that experience, has made relevant proposals in relation to the new licensed area.

⁸⁵⁰ Ibid, p. 233.

⁸⁵¹ Ibid.

⁸⁵² Ibid, p. 145.

⁸⁵³ Ibid, p. 76.

⁸⁵⁴ Ibid, p. 75.

⁸⁵⁵ Ibid, pp. 218 and 221.

⁸⁵⁶ Ibid, pp. 210 – 237.

Developing relationships with business and social landlords

- 9.7.35 PNGL affirms the importance of developing the relationships necessary to drive connections and sets out its experience in dealing with business and social landlords and relevant existing relationships in its current licensed area.
- 9.7.36 PNGL points to its established relationship with NIHE⁸⁵⁷ and with trade associations such as CBI, Manufacturing Northern Ireland, and the Federation of Small Businesses⁸⁵⁸. However, whether PNGL has already begun to engage with business and NIHE in the new licensed area is unclear. PNGL states that ‘across all sectors Phoenix sees its relationship with potential customers in the GTW Licensed Area starting at the mobilisation phase’⁸⁵⁹.
- 9.7.37 PNGL states that it established a professional working relationship with the NIHE in 2001 and through this has persuaded it to adopt natural gas as its fuel of choice, where available, for all heating replacements on its 15-year replacement cycle. PNGL notes that whilst this is NIHE's current policy, each tenant must then be persuaded of the benefits of natural gas otherwise they can choose to convert to oil or biomass - NIHE will not insist that a tenant in one of its properties install a natural gas heating system. PNGL therefore notes that continued market development is therefore required to persuade tenants that natural gas should be their preferred option⁸⁶⁰.
- 9.7.38 PNGL also states that many NIHE properties in the new licensed area will have had an oil boiler installed within the last 15 years due to the unavailability of natural gas at that time. PNGL states that it is therefore conscious that engagement with NIHE tenants is a vital part of its maximisation of connections in this sector⁸⁶¹.
- 9.7.39 PNGL states that the close and trusted working relationship between Phoenix and NIHE means that the number of natural gas conversions are maximised each year. Joint planning of operations means that in some instances network construction is rescheduled to meet the NIHE's timescales and in other

⁸⁵⁷ Ibid, pp. 220 and 227.

⁸⁵⁸ Ibid, pp. 219 and 247.

⁸⁵⁹ Ibid, p. 221.

⁸⁶⁰ Ibid, p. 220.

⁸⁶¹ Ibid.

instances heating system replacements are delayed to allow PNGL time to construct the network. PNGL states that this approach has been essential in delivering a successful industry in its existing licensed area as almost one-in-four properties connected to its network are NIHE properties and eight out of ten NIHE properties are using natural gas⁸⁶². It also states that it will work with the NIHE and its appointed contractors to ensure gas availability in areas that are eligible for heating replacement programmes and will, in tandem, implement its engagement strategy with the public.

9.7.40 In relation to business, PNGL also points to the importance of relationships with the building community to identify opportunities in regard to maximising gas connections to new build properties where gas is available. It states that in the existing licence area, where the PNGL network does yet not reach a proposed development, it has initially supplied the development with gas via an underground Calor Gas tank and then converted the development to gas when the network has extended to the appropriate point⁸⁶³. PNGL states that its New Build representatives will be responsible for developing relationships with Housing Associations based in the new licensed area⁸⁶⁴.

9.7.41 PNGL states that it has a well-established relationship with the trade that services the large scale industrial and commercial market. It also states that preliminary profile work has been carried out in relation to industrial and commercial customers in the new licensed area.⁸⁶⁵ In relation to smaller commercial customers, it states that to date over 11,000 such properties are connected to its existing network meeting needs with respect to catering, space heating and hot water⁸⁶⁶.

9.7.42 The Authority considers that PNGL has provided detailed information in regard to its existing relationships with businesses and NIHE and its proposals to build on these relationships to maximise the number of premises connecting to the new network.

⁸⁶² Ibid.

⁸⁶³ Ibid, p. 228.

⁸⁶⁴ Ibid.

⁸⁶⁵ Ibid, p. 229.

⁸⁶⁶ Ibid, pp. 230 – 231.

Connections to vulnerable customers

- 9.7.43 In relation to experience of promoting connections to vulnerable customers, PNGL points to its existing Priority Consumer and Vulnerable Consumer identification processes⁸⁶⁷, its Older People's Strategy⁸⁶⁸, and its identification of customers eligible for the boiler replacement allowance⁸⁶⁹.
- 9.7.44 In particular, PNGL highlights the role of energy advisors in identifying whether a homeowner may qualify for assistance with a range of measures, including replacement heating systems. PNGL estimates that around 1,000 homeowners are identified and signposted to the various fuel poverty schemes (e.g. Warm Homes) by its sales team each year⁸⁷⁰. PNGL intends to expand these initiatives and strategies to the new licensed area.
- 9.7.45 The Authority notes that while all of the measures which PNGL describes will assist vulnerable customers, the application does not always explain clearly how these measures (such as the Age Sector Platform which is part of the Older People's Strategy) will assist in promoting connections to these customers as required by paragraph 3.20(b)(iv) of the Criteria.

Final score for criterion 3.17(c)

- 9.7.46 The Authority considers that PNGL has provided detailed information in respect of most of the elements of subparagraph 3.20(b) of the Criteria. The information which it has provided in relation to subparagraph 3.10(b)(iv) is not always strictly relevant to the requirements of that subparagraph, however.
- 9.7.47 The Authority particularly notes PNGL's experience of construction and system operation and its proposals for mobilisation based on its experience in its existing licensed area. The Authority places weight on PNGL experience in operating its own control room. The Authority considers that proposals for connections are well described and notes that PNGL has existing relationships with local installers, businesses, and other stakeholders. The Authority particularly notes that the pattern of connections, including a focus on owner

⁸⁶⁷ Ibid, p. 154.

⁸⁶⁸ Ibid, p. 232.

⁸⁶⁹ Ibid.

⁸⁷⁰ Ibid, p. 231.

occupiers, to be applied in the G2W area is consistent with the model PNGL applies in the Belfast area.

9.7.48 However, the Authority also notes that whether PNGL has already begun to engage with business and NIHE in the new licensed area is unclear and that PNGL's assessment of the number of 'addressable properties' in each town and the demographic make-up of the new area is not as advanced as that of firmus.

9.7.49 On the basis of the above the Authority confirms that its final decision is to award a score of 16 marks out of 20 to PNGL's application in relation to paragraph 3.17(c).

9.8. Specific Criteria – Innovation & Technology

9.8.1 PNGL has sought to address innovation and technology transfer in a standalone document submitted as part of its application (the ITT).

9.8.2 The same document is used as part of PNGL's applications for both the high and low pressure licences and neither tailored to either licence specifically.

9.8.3 The ITT does not address the matters listed in paragraph 3.21 of the Criteria systematically. Instead it seeks to demonstrate a history of innovation within PNGL, the factors driving the delivery innovation, and outputs such as cost efficiencies.

Environmental sustainability

9.8.4 The ITT does not address environmental sustainability directly and provides limited information in relation to PNGL's ability to achieve innovation and technology transfer in this regard.

9.8.5 PNGL states that it is working with a consortium to explore the opportunities around biomethane being injected into the natural gas grid in Northern Ireland⁸⁷¹. It is also exploring the possibility of running its own fleet of vehicles on

⁸⁷¹ PNGL, *Gas Network Extensions in Northern Ireland: Gas to the West ("GTW"): Phoenix Innovation and Technology Transfer*, p. 16.

compressed natural gas (CNG).⁸⁷² Little detail is provided on either initiative, however.

- 9.8.6 PNGL also points to a number of initiatives which will reduce waste such as the introduction of smaller directional drilling rigs in urban areas. PNGL states that a reduction in fuel usage by 5% per annum can be achieved by installing tracker devices on all operational vehicles and through better work planning⁸⁷³.

Efficiency in use of gas and new sources of gas

- 9.8.7 The ITT does not address efficiency in the use of gas directly. In relation to the use of new sources of gas, the reference to the use of biomethane discussed above is relevant but no details are provided which would allow the Authority to assess the proposal.
- 9.8.8 The Authority notes PNGL's statement that one outcome from the introduction of pre-assembled meter installation is a reduction in gas leakage⁸⁷⁴.
- 9.8.9 As stated above in 2.9.1 where the applicant is applying for a low pressure licence the Authority would expect to see evidence of innovative technologies to reduce customers' consumption of gas. In this respect PNGL points to the conversion management support it provides to customers wishing to convert to gas and which it proposes to replicate in the new licensed area.

Cost efficiency

- 9.8.10 PNGL provides details of a number of projects and provides identified cost savings for some of them. One example is the introduction of smaller directional drilling rigs in urban areas which PNGL estimates has saved approximately £20m compared to traditional open cut methodologies.⁸⁷⁵ Another is the use of 4bar MP network and direct connection of properties to the network (a practice which differs from standard practice in Great Britain). PNGL states that a

⁸⁷² Ibid.

⁸⁷³ Ibid, p.8.

⁸⁷⁴ Ibid, p. 7.

⁸⁷⁵ Ibid, p. 8.

conservative estimate of the savings in construction cost delivered by these two innovative approaches to date is approximately £40m⁸⁷⁶.

Development of the network to more remote geographical areas

- 9.8.11 The development of the gas network is dealt with in chapter 10 of the ITT⁸⁷⁷. This predominantly seeks to highlight successes in developing the network in the current licensed area as a means to demonstrate evidence how PNGL would develop the network in the new licensed area. However, the information supplied is not tailored to innovation in relation to the development of the new network to more remote geographical areas.

History of innovation

- 9.8.12 PNGL outlines a number of innovations which are discussed at pages 5 to 9 of the ITT. These include the introduction of an integrated flow limiter and the use of pre-assembled meter installation.
- 9.8.13 The Authority considers that these examples may be directly relevant to the network in the new licensed area and illustrate an ability to innovate more generally.
- 9.8.14 This view is supported by the report from Rune which states that PNGL has demonstrated a track record of innovation in relation to low pressure networks⁸⁷⁸.

Ability to secure funding

- 9.8.15 PNGL states that it has previously secured funding from the Department of Learning, Energy and Utility Skills and the Construction Industry Training Board to support training and accreditation for its staff⁸⁷⁹.
- 9.8.16 PNGL also points to the fact that it has worked effectively with Local Government to promote the benefits of converting to natural gas and states that this approach

⁸⁷⁶ Ibid, p. 5.

⁸⁷⁷ Ibid, p. 22.

⁸⁷⁸ RUNE Associates, op cit, p. 25.

⁸⁷⁹ Ibid, p.14.

has resulted in Local Government introducing funding streams which support connections, such as NIHE funding for heating system conversions.⁸⁸⁰

- 9.8.17 The Authority considers that PNGL has provided some evidence of its ability to secure funding. However, the examples provided have not been of funding to support innovation. This view is supported by the report from Rune which also concludes that 'there is no direct evidence of securing funding for innovative developments'⁸⁸¹.

Transfer of innovation into Northern Ireland

- 9.8.18 PNGL provides no substantive proposals to transfer any innovation into Northern Ireland. Rather it proposes the transfer of innovations within Northern Ireland from its existing licensed area to the new licensed area. This view is supported by the report from Rune⁸⁸².

- 9.8.19 The application mentions that PNGL is committed to exploring CNG opportunities in the new licensed area and that if biomethane can be injected into the network then it could be transported to any customer connected to the network.⁸⁸³ Little detail is given in regard to this proposal, however.

Existing skills and experience

- 9.8.20 The existing skills and experience of PNGL staff in relation to innovation are not detailed in the application, instead the application discusses PNGL's existing approach to staff development generally and it is stated that the approach described will be duplicated within the new licensed area.⁸⁸⁴
- 9.8.21 Paragraph 3.21(b)(iv) of the Criteria refers to 'existing skills and experience'. The Authority therefore gives no credit in relation to this paragraph in respect of any skills or experience which may be gained in the future.

⁸⁸⁰ Ibid, p. 20.

⁸⁸¹ RUNE Associates, op cit, p. 25.

⁸⁸² Ibid.

⁸⁸³ PNGL, ITT, p.16.

⁸⁸⁴ Ibid, pp.13 - 14.

9.8.22 However, the Authority recognises that there is some overlap between this subparagraph and subparagraph 3.21(b)(i) as evidence of a history of innovation is one way in which skills and experience may be demonstrated.

9.8.23 PNGL has therefore been given some credit for the examples of innovation that it has presented in its ITT, as discussed above.

Final score for the ITT criteria

9.8.24 The evidential burden is on the applicant to provide the Authority with information on which to base its assessment under paragraph 3.21 of the Criteria.

9.8.25 In respect of the matters listed in subparagraph 3.21(a), PNGL has provided evidence in relation to its ability to achieve innovation and technology transfer in relation to environmental sustainability and efficiency in the use of gas. However, the Authority would have expected to see a proposal, tailored to innovation, for the development of the network to more remote geographical areas.

9.8.26 In respect of the matters listed in subparagraph 3.21(b) PNGL has provided a number of examples of past innovation and has also demonstrated an ability to secure funding. However, the examples given for PNGL's ability to secure funding have not been of funding to support innovation specifically. Also proposals to transfer innovation into Northern Ireland are limited.

9.8.27 On the basis of the above, the Authority confirms that its final decision is to award a score of 12 out of 20 to PNGL's application in relation to innovation and technology transfer.

9.9. Resources Criteria

9.9.1 As explained in chapter 2 of the provisional decisions⁸⁸⁵, the Authority considered there to be a close connection between an applicant's score with respect to the Best Value Criterion and the assessment of whether it has met the Adequate Resources Criterion and the Financial Resources and Standing

⁸⁸⁵ Chapter 2, paragraphs 2.7.23 to 2.7.29

Criterion. This is because of the substantial overlap in the information which is relevant to each.

- 9.9.2 The Authority therefore used its detailed analysis of the information provided with respect to the Best Value Criterion, as outlined above, as a basis for its assessment of whether PNGL has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion.
- 9.9.3 Where an applicant has achieved scores which are consistently within the medium to high parts of the range in the assessment of its OBP it might be expected that its application would reveal a broad adequacy of resources for the purposes of the licence. This is the case even if the Authority's detailed analysis of that applicant's OBP found there to be some inadequacies in the information provided.
- 9.9.4 Where an applicant has been attributed one or more scores which are within the low part of the range in the assessment of its OBP – in other words, where it has achieved less than half of the marks that are available against at least one element of sub-criteria 3.17(a) to (c) – the Authority has considered carefully whether its application reveals an adequacy of its resources.
- 9.9.5 PNGL has been attributed scores which fall within the medium to high range in respect of all of the elements of its OBP. Its application was supported by comprehensive, detailed and credible information, systematically addressed the relevant issues, and provided a clear and justified rationale.
- 9.9.6 In particular the Authority took into account that its proposed WACC of 5.7% and 5.35% fell within NERA's plausible range and was such that it would be able to raise the finance required to construct and operate the low pressure network while subject to a revenue control condition embodying that WACC.
- 9.9.7 The Authority's final conclusion is that PNGL has demonstrated that it has the required resources to meet the obligations of the licence and thus has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion.

10.0 SGN Low Pressure Connected

10.1. Introduction

10.1.1 This chapter:

- a. considers the application made by Scotia Gas Networks Northern Ireland Ltd (**SGN**) for the low pressure licence, which is connected to the Northern Ireland Energy Holdings application for the high pressure licence;
- b. the responses received to the consultation on the provisional decisions, as these relate to the connected low pressure application made by SGN
- c. sets out the Authority's final conclusions as to whether SGN has met each of the criteria other than the Best Value Criterion;
- d. sets out the Authority's final assessment of the marks to be awarded to SGN in respect of the different elements of the Best Value Criterion;
- e. explains the reasons of the Authority for its final conclusions and marks.

10.1.2 In this chapter, the criteria have been addressed in the order in which they are set out in Chapter 2 of the provisional decisions, and the Authority has followed the approach to interpreting and applying the criteria that is set out in that chapter.

10.2. The Information Criterion

10.2.1 Both an electronic and a printed copy of the SGN application were received by the Authority before the deadline of noon on 6 May 2014

10.2.2 Once the deadline had passed the application was opened and checked for completeness against a pre-prepared checklist. The application was assessed as being complete except in two respects:

- a. it was not clear from the application what information was being relied on by SGN for the purposes of meeting the Adequate Resources Criterion;

and

- b. it was not clear from the application what information was being relied on by SGN for the purposes of meeting the Financial Resources and Standing Criterion.

10.2.3 SGN was informed of these apparent omissions and was given until noon on 14 May 2014 to provide the missing information. A response was received by the deadline and it was subsequently judged that this addressed the omission in full⁸⁸⁶.

10.2.4 Having considered these facts, the Authority concluded that SGN has provided all the information requested by the Authority, in such manner and by such times as was specified, and therefore meets the Information Criterion.

10.3. The Constitution Criterion

10.3.1 SGN is a limited company with its registered office in England. SGNs constitutional documents were provided to the Authority in accordance with paragraph 6 of Schedule 2 to the Application Regulations⁸⁸⁷.

10.3.2 Having considered this evidence, the Authority was satisfied that SGN has demonstrated that it is properly constituted in accordance with the law and holds all registrations, authorisations or approvals required to be held by an entity of its type.

10.4. The Fit and Proper Person Criterion

10.4.1 Evidence to demonstrate that SGN is a fit and proper person was provided to the Authority in accordance with paragraphs 20 to 26 of Schedule 2 to the Application Regulations⁸⁸⁸. It consisted of a signed statement by a senior officer of SGN to the effect that SGN had no information to disclose under any of those paragraphs.

⁸⁸⁶ Clarification letter 1

⁸⁸⁷ SGN LP Application Form

⁸⁸⁸ Ibid

- 10.4.2 The Authority noted that SGN has no record of enforcement action being taken against it, or any other adverse factor of the type listed in the Application Regulations.
- 10.4.3 On the basis of the evidence provided to it, the Authority was therefore satisfied that SGN meets the Fit and Proper Person Criterion.

10.5. Specific Criteria – Operational Business Plan 3.17(a)

Engagement with stakeholders

- 10.5.1 SGN provides a comprehensive list of the stakeholders which it has identified as relevant in relation to the construction of the network. With respect to each identified stakeholder, it outlines the high level messages and rationale for engagement and a high level description of the channels through which such engagement will take place⁸⁸⁹.
- 10.5.2 SGN also describes the principles which underpin its stakeholder engagement plan and states that, once appointed, its senior management team will take responsibility for establishing those principles, the initial engagement with the relevant regulatory authorities and building the stakeholder engagement plan⁸⁹⁰.
- 10.5.3 SGN states that it envisages early discussions with CCNI to share its construction plans and anticipated connections dates and to seek feedback on its proposals. It also identifies the high pressure licence holder as a key stakeholder and states its belief that its JV arrangements with NIEH will simplify engagement and deliver significant benefits in overall project management⁸⁹¹.
- 10.5.4 The OBP also states that SGN's Business Development team will play a key role in ensuring the reach, and appropriate management, of its consultations. In addition, SGN will ensure that it has internal processes to keep its operational staff and contractors informed so that they can consult with roads, other utilities and community representatives to ensure views from those stakeholders are taken into account and that they are kept fully informed.

⁸⁸⁹ SGN, *Low Pressure Operational Business Plan*, p. 56 – 57.

⁸⁹⁰ Ibid, p. 55.

⁸⁹¹ Ibid.

10.5.5 The Authority considers that SGN has provided information which demonstrates that it has identified an appropriate range of stakeholders. It has also demonstrated that it has in place detailed and appropriate proposals for its engagement with key stakeholders.

10.5.6 The Authority notes that there is some reference in the OBP to existing relationships with stakeholders in Northern Ireland (such as the Northern Ireland Housing Executive⁸⁹²) but that the number and extent of such relationships is limited.

Skills and experience

10.5.7 SGN states that it currently manages 74,000km of distribution network infrastructure in Scotland and the South of England and that its two networks have demonstrated a track record in both financial and operational excellence during its recent five year price control (GDPCR1). In addition, during the last five years SGN has delivered around 100,000 new connections and states that it has significantly exceeded its fuel poor connection targets with more than 20,000 customers connected to date⁸⁹³.

10.5.8 In section 2.3.2 of its OBP, SGN states that until the recruitment of a management team and staff in Northern Ireland, its initial activities in Northern Ireland will be led by its Managing Director (Scotland), Financial Director of Operations and Head of Business Development⁸⁹⁴. Summaries of the skills and experience of these personnel are provided⁸⁹⁵.

10.5.9 These individuals will be supported by members of the project team which worked on SGN's bid and summaries of the skills and experience of these personnel are also provided⁸⁹⁶.

10.5.10 In relation to its recruitment in Northern Ireland, SGN states that it will adopt an open recruitment process for senior management positions and hopes to draw from highly qualified employees within its business, as well as attracting high

⁸⁹² Ibid, p. 111.

⁸⁹³ Ibid, p. 7.

⁸⁹⁴ Ibid, p. 38.

⁸⁹⁵ Ibid, p. 39.

⁸⁹⁶ Ibid, p. 40.

calibre individuals from the market. SGN states, however, that if resources cannot be recruited then a contingency plan is in place to secure resources from within the SGN group⁸⁹⁷.

10.5.11 SGN states that although it considers itself to have all the skills and resources within its business to manage and perform the activities under the licence, it recognises that the use of contractors is most economic where volumes are high or activities are short lived. It therefore proposes to use the skills and resource of its existing businesses via managed service arrangements. It will also tender for framework contracts with local contractors to provide emergency support and initial build out of infrastructure⁸⁹⁸.

10.5.12 Although SGN does not have a contract in place for construction it states that, as an existing operator of two large networks, it has strategic long-term framework contracts in place for the supply of the majority of materials necessary to construct the distribution network⁸⁹⁹. Contracts for other services such as emergency call handling will also be provided under existing contracts⁹⁰⁰.

10.5.13 SGN recognises, however, that as new entrants to the Northern Ireland market it will need to establish a range of additional service contracts during both construction and ongoing operations⁹⁰¹.

10.5.14 The Authority considers that SGN has provided information which illustrates that many of the staff with the skills and experience to undertake the activities required by the licence are already in place within the organisation and can undertake the relevant activities until a project management team is established within Northern Ireland. The Authority notes in particular the presence of a contingency plan if such recruitment is unsuccessful and considers that SGN has demonstrated, on the basis of its previous experience, that it has a pool of relevant resources within the organisation to draw from in that eventuality.

10.5.15 The Authority also considers that (apart from construction) arrangements are either in place with contractors for the key activities needed, or that existing

⁸⁹⁷ Ibid, p. 49.

⁸⁹⁸ Ibid, p. 11.

⁸⁹⁹ Ibid, p. 97.

⁹⁰⁰ Ibid, p.97 and p.32.

⁹⁰¹ Ibid, p. 99.

arrangements can be extended to cover the new licensed area. Although the Authority cannot directly assess either the nature of the contracts which SGN has in place, or the skills and experience of the persons with whom it has such arrangements, the experience upon which SGN can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate.

- 10.5.16 Where arrangements are not in place, SGN has provided information which demonstrates that it has the skills and experience in relation to low pressure networks necessary to secure and manage any additional resource needed.

The management of risk

- 10.5.17 SGN sets out its policy and processes to identify and manage risk issues in section 4.1 of its OBP. It is stated that SGN will extend its existing process with respect to the management of risk to the activities which are required under the licence⁹⁰².
- 10.5.18 SGN states that it employs an Enterprise Risk Management approach and that its risk governance structure is underpinned by a risk management policy and procedures and covers all areas of its business (including Engineering, Operations, IT and Finance). At a strategic level, its Risk Committee monitors the effectiveness of SGN's risk processes and controls and provides assurance to its Executive and Board. The Risk Committee works in tandem with SGN's Audit Committee via an audit charter. Outputs are made visible via risk registers, strategic risk bubble graphs and risk dashboards⁹⁰³.
- 10.5.19 The OBP also provides detail regarding the identification and quantification of risk issues, including significant asset risk issues⁹⁰⁴. A description is also given of the procedures which SGN uses to mitigate risk. This states that management information generated from its risk identification processes is used at all levels of its business to monitor performance and/or to track corrective actions to completion (for example, via SGN's Risk Committee and Distribution

⁹⁰² Ibid, p. 75.

⁹⁰³ Ibid, p. 67.

⁹⁰⁴ Ibid, p. 72 – 74.

Engineering Safety Committee, Executive and Board oversight and its significant incident investigation tracker)⁹⁰⁵.

10.5.20 Elsewhere, the OBP states that asset faults are captured and reported in accordance with the SGN/PM/FAULT/1 Fault Reporting Procedure as well as via pressure systems inspections and by Gas Control (where detected via system monitoring equipment). SGN states that it operates an Engineering Forum which uses fault and other asset condition intelligence to identify developing risk issues and initiate corrective action. Incident investigation reports also feed into this process via SGN's Incident Review Panel⁹⁰⁶.

10.5.21 Significant operational risks are managed using SGN's Safe Control of Operations (SCO) and Permit to Work processes, which are also described⁹⁰⁷.

10.5.22 SGN states that it has applied its risk management approach to the activities which it would undertake under the licence⁹⁰⁸. The OBP includes a table which outlines the risk identified, the probability of it occurring, the consequences if it does and SGN's proposals for mitigation. The risks identified include limited interest from third parties in taking on a supply and a major third-party incident on the network with insufficient insurance to compensate the network for works undertaken.⁹⁰⁹

10.5.23 The Authority considers that SGN has identified a number of relevant risks associated with the activities which it would be required to undertake under the licence. It has also provided evidence that it has robust systems in place to deal with such risks, and to identify others, and has presented suggestions for the avoidance and mitigation of the risks it has identified thus far.

10.5.24 This view is supported by the report from Rune⁹¹⁰.

⁹⁰⁵ Ibid, p. 74.

⁹⁰⁶ Ibid, p. 89.

⁹⁰⁷ Ibid, p. 75.

⁹⁰⁸ Ibid, p. 12.

⁹⁰⁹ Ibid, p. 132.

⁹¹⁰ RUNE Associates, op cit, p. 4.

Tendering arrangements

- 10.5.25 SGN sets out its approach to procurement in section 6 of its OBP. SGN states that it manages its internal procurement arrangements through a managed service agreement from Scottish and Southern Energy (SSE) and that this will benefit SGN's new business in Northern Ireland through its significant buying power alongside economies of scale. For example, during 2013 SGN states that it purchased over 2,600km of Polyethylene (PE) pipe from its suppliers⁹¹¹.
- 10.5.26 Policies and principles to ensure compliance with EU procurement regulations are described and Authority levels and financial controls are specified⁹¹².
- 10.5.27 In section 1.2.2 of the OBP, SGN states that it will secure external resources for mobilisation through existing framework agreements with suppliers, wherever possible⁹¹³. In regard to materials section 6.2.2 provides details of contracts which SGN already has in place with respect to PE pipe and fittings, the provision of meters and pressure reduction equipment⁹¹⁴.
- 10.5.28 Information regarding the contracts required for construction, maintenance and specialist services is provided in section 6.3, and it is stated that the majority of these contracts will be awarded during the first three months of mobilisation. SGN proposes to utilise existing contracts for specialist services if possible and states that it already has a number of specialist contracts in place to support operations for its existing networks which it will extend or renegotiate these as necessary to accommodate its work in Northern Ireland⁹¹⁵. Such specialist services include pipeline emergency services for steel and non-steel distribution (and transmission) assets, including the provision of technical advice and the availability 24/7 of specialist labour, materials and equipment⁹¹⁶.
- 10.5.29 No construction contract is in place and SGN states that it would tender for the main engineering contract for the construction of the mains and services during

⁹¹¹ SGN, op cit, p. 94.

⁹¹² Ibid, pp. 95 – 96.

⁹¹³ Ibid, p. 14.

⁹¹⁴ Ibid, p. 98.

⁹¹⁵ Ibid, p. 98.

⁹¹⁶ Ibid, p. 100.

month three of the mobilisation period using the existing approach which it has described.

10.5.30 The Authority considers that SGN has provided detailed information regarding its proposals as to the use of tendering arrangements and that its tendering arrangements are robust, in line with best practice and proven through use in previous projects. The Authority notes that SGN will be able to utilise some contracts which it already has in place in relation to materials and specialist services.

10.5.31 Rune's advice also indicates that SGN's proposals for tendering are robust.⁹¹⁷

Final score for 3.17(a)

10.5.32 SGN has provided a comprehensive statement, backed by appropriate evidence, of how it will undertake the activities which would be the subject of obligations set out in the licence for which it has applied.

10.5.33 The Authority particularly notes that, despite SGN's proposals for engagement, its existing relationships with stakeholders in Northern Ireland are weak. The Authority also notes SGN's previous experience in relation to the construction and operation of low pressure networks and that where skills and experience need to be sourced externally contracts are in place or can be extended where required. Proposals for the management of risk and tendering arrangements were also robust.

10.5.34 On the basis of the above the Authority confirms that its final decision is to award 14 marks out of 20 to SGN in relation to subparagraph 3.17(a).

10.6. Specific Criteria – Operational Business Plan 3.17(b)

10.6.1 The Application Information Pack asked applicants to supply costs for WACC, Operating Expenditure and Mobilisation Costs and the Authority considers SGN's application submission of costs in this section. For the purposes of this paper the Authority dealt with the costs under two headings – WACC and

⁹¹⁷ RUNE Associates, p. 8.

Operating Expenditure. The Authority's views on Mobilisation costs are included under the Operating Expenditure heading. The Authority set out in the Application Information Pack⁹¹⁸ greater detail on what these costs might include.

Description of the derivation of cost data

Weighted Average Cost of Capital

10.6.2 NERA was requested to produce a report on what it would expect to see in a well-evidenced WACC submission. The Authority substantially agreed with the assessment reflected in that report. It follows the Authority would have expected to see:

- a. The cost of debt set out using: (i) a benchmark gilt yield (to reflect a risk free rate) plus evidence on corporate debt spreads with market evidence provided for both; and/or (ii) direct evidence of corporate debt yields with market evidence provided. For this purpose, references to corporate debt spreads/yields should reflect companies with similar risk profiles, issuance costs should be included in the cost of debt and the treatment of inflation should be clearly explained in the derivation.
- b. The cost of equity set out using CAPM and incorporating the risk free rate, equity risk premium and beta with relevant evidence provided to justify each component.
- c. The proposed gearing including a discussion on the how this interacts with the risks of the project, the proposed credit rating and the cost of debt.

10.6.3 The application is based on a standard debt / equity capital structure and includes proposals for both debt and equity costs applying the CAPM model to propose a WACC range of 6.2% in Years 1 to 5 and 5.5% in Years 6 to 10.⁹¹⁹

10.6.4 For years 1 to 5 the required WACC equates to the rate of return received by equivalent GB network owners plus a risk premium.⁹²⁰ This risk premium is calculated as being the difference between the firmus WACC of 7.5% and the

⁹¹⁸ Applicant Information Pack Annex 8

⁹¹⁹ SGN(NI) OBP, p.

⁹²⁰ SGN LP Business Plan – Section 10.1.1

rate of return received by equivalent GB network owners at the time the firmus licence was granted.

- 10.6.5 This premium is split between a Northern Ireland specific risk premium of 0.4% and what is termed a Start Up premium of 1.0%⁹²¹. This latter premium is then adjusted upwards to take account of the shorter period the G2W licence holder will receive the premium for (5 years as opposed to the 12 years in the case of firmus) to arrive at 1.5% giving a total risk premium of 1.9%. When added to recent GB WACC precedent of 4.3% and 5% this produces a total range of 6.2% to 6.9%⁹²². This is then cross checked by adjusting the firmus 7.5% WACC to reflect latest gilt rates to produce a range of 6.1%-6.3% and a figure of 6.2% is then selected as the WACC
- 10.6.6 For years 6 to 10 the application calculates the WACC in line with standard regulatory practice with the derivation of the value in the Data Input Workbook being clearly explained in a high level of detail. The application is accompanied by a detailed paper from Oxera⁹²³ which provides more detail and evidence to explain the proposed WACC.
- 10.6.7 The build up of the cost of debt is clearly identified⁹²⁴ and accompanied with a good explanation as to why the relevant figure was used and the evidence to justify it.
- 10.6.8 The build up of the cost of equity is comprehensively set out with a full discussion of all elements to arrive at a proposed WACC in years 6-10 of 5.5%. The Authority notes that the WACC in Years 6-10 also includes a NI premium and an explanation is provided for this.⁹²⁵
- 10.6.9 There is also an explanation as to how the 5.5% WACC has been adjusted when inputted into the Data Input Workbook.

⁹²¹ SGN LP Business Plan p150

⁹²² SGN LP Business Plan p151

⁹²³ Oxera

⁹²⁴ SGN LP Business Plan p152

⁹²⁵ SGN LP Business Plan p152-153

10.6.10 The explanation of the derivation of WACC is well explained and detailed with clear tables⁹²⁶ allowing all the calculations to be followed.

Operating Expenditure

10.6.11 Mobilisation – the build up of costs was clearly described with Figure 4 summarising all costs and a reasonable discussion explaining the costs.⁹²⁷ There was an additional amount of detail in Figure 5 to further explain staff costs which is the largest mobilisation cost line. However the Authority notes that the Data Input Workbook has not included calculations of how the costs are built up and so would regard the level of detail as less than comprehensive.

10.6.12 The Authority also notes that staff cost mobilisation total in Figure 5 of £0.558m appears to be inconsistent with the figure provided in Figure 4⁹²⁸ of £0.575m. The error suggests the accuracy of the information provided is not complete.

10.6.13 Operating Expenditure -The build up of costs has been well set out in both narrative and tabular form at a reasonable level of granularity⁹²⁹. However the application could have been improved by a greater level of granularity and the use of a spreadsheet presentation of cost build up.

10.6.14 There is a good description of marketing and manpower costs and Figures 1 and 2. Annexe B also provides more detail. The application explains that much of these costs are covered by the owner occupier incentive but it is very difficult to follow the calculations with the tables presented and how the final figure was arrived at is not clear. This is a good example where a detailed spreadsheet would have produced an improved application.

10.6.15 One discrepancy which has been identified relates to the provision of financial incentives to non domestic consumers between the OBP⁹³⁰ where it states that these will only be available for the first five years, but in the Data Input Workbook costs have been included for the first eight years.⁹³¹

⁹²⁶ SGN LP Business Plan p149-154

⁹²⁷ SGN LP Business Plan – Section 3.4

⁹²⁸ SGN LP Business Plan – p52

⁹²⁹ SGN LP Business Plan – Section 8.2 and Annexe B

⁹³⁰ SGN LP Business Plan – p. 127.

⁹³¹ SGN LP Data Input Workbook – Operating Expenditure worksheet Row 18.

Identification and application of cost drivers

Operating Expenditure

10.6.16 Operating Expenditure - Cost drivers have been clearly identified in some areas with the GD14 price determination being referenced as a source for these drivers⁹³². The description of some costs areas is very limited e.g. insurance and IT⁹³³, although the Authority notes that manpower and emergencies have reasonable descriptions and they are some of the larger cost items.

10.6.17 However while the discussion on cost drivers is good there are a number of cost drivers missing in the tables where no numbers are provided. For example Figures 2 and 3 do not provide unit rates to calculate the final figure⁹³⁴.

Robustness of assumptions

10.6.18 The Authority identified and considered a number of assumptions that appeared to have been made by SGN when deriving the data contained in its Data Input Workbook.

The Value of the WACC

Weighted Average Cost of Capital

10.6.19 First, the Authority took it to be implicit throughout the application that Scotia Gas (SGN) had assumed it will be able to carry on the licensed activities under the low pressure licence, and to do so consistently with its obligations under that licence, on the basis of the proposed WACC. That is to say, there was an implicit assumption that SGN will be able to raise the finance required to construct and operate the low pressure network while subject to a revenue control condition embodying its proposed WACC.

10.6.20 For the purpose of testing this assumption, the Authority considered whether the proposed WACC fell within the range of what might reasonably be expected in the context of the G2W project. To do this, it considered the market cost of debt and equity based on advice received from NERA, which took into account in its

⁹³² SGN LP Business Plan – p. 128 Emergency Call Outs.

⁹³³ SGN LP Business Plan – p.131.

⁹³⁴ Ibid – p. 128.

report such costs as referenced in recent regulatory decisions⁹³⁵. NERA advised on what it considered to be the 'plausible range' within which it would expect any WACC for this project to lie. The Authority relied upon the advice contained in the report as establishing a range against which to test SGN's assumption

10.6.21 NERA established a 'plausible range' in respect of a corporate finance structure of between 3.5% and 6.2%, and SGN's proposed WACC of 6.2% in years 1 to 5 and 5.5% in years 6 to 10.

10.6.22 The Authority noted that the proposed SGN WACC lay at the high end of, but fell within, the range identified by NERA.

10.6.23 In addition SGN supported its application by referencing the financial strength of the parent and that parent's history of raising finance for gas transportation assets in Great Britain. In addition some letters of comfort from financial institutions were also referenced⁹³⁶.

10.6.24 The Authority considered that these letters of comfort did not represent a firm commitment by the relevant banks to provide the required financing. The letters note that any future funding commitment would be conditional on several factors, including credit market conditions, satisfactory due diligence, the final form of the legal documents and the licence, and other factors. They are not legally binding, nor do they purport to be so. Moreover, the Authority did not understand them to commit the banks in any sense that might properly be regarded (even allowing that they fall short of a legal obligation) as entailing a 'firm' commitment.

10.6.25 In order to clarify whether its understanding of the status and effect of the comfort letters was correct, the Authority sought advice from both NERA⁹³⁷ and the Strategic Investment Board⁹³⁸. Each of them confirmed the Authority's initial view that there was significant conditionality attached to the letters, including in relation to due diligence and internal bank clearances. The Strategic Investment Board noted that while the letters 'certainly indicate willingness from the funders

⁹³⁵ NERA, Gas to the West, A report for the Utility Regulator

⁹³⁶ Clarification letter 1

⁹³⁷ NERA, Gas to the West, A report for the Utility Regulator p.21.

⁹³⁸ SIB – Letter to Uregni (2).

concerned to participate in the project', it did 'not believe that the letters can be relied upon as evidence'. The Authority accepted this advice.

10.6.26 This did not entail any conclusion that the letters of comfort were inappropriate. The Authority recognised that funding commitments are likely to be contingent on, and related to the conditions of, the licence as granted; in particular on the terms of the price control which determine the value of the income stream that can be generated by the licence holder.

10.6.27 Moreover, the Authority did not consider that there was any ground for materially distinguishing between the weightings between applicants. It accepted the advice of the Strategic Investment Board in this respect.

10.6.28 However, while accepting that a comfort letter indicates a willingness on the part of the relevant funder to participate in the project, the Authority considers that no material degree of weight can be attached to such letters for the purposes of demonstrating SGN's cost of debt

10.6.29 Having regard to its own expertise, the Authority considered that the proposed WACC was high and therefore reflective of a cost of debt and equity that would attract investors. Given that the WACC also lay within NERA's plausible range, and given the historical evidence presented, the Authority had no concerns about the ability of SGN to finance its activities under the low pressure licence on the basis of the proposed WACC.

10.6.30 Therefore the Authority concluded that the assumption that SGN would be able to obtain financing to carry on the licensed activities on the basis of the proposed WACC was robust.

Risk Premia

10.6.31 The application includes an assumption that a Northern Ireland risk premium is appropriate and quotes the Competition Commission determination on Northern Ireland Electricity as confirming the existence of a Northern Ireland specific risk premium.

10.6.32 The Authority therefore finds the assumption of such a premium is not robust.

10.6.33 The application assumes a start up premium of 1.5%. There is a detailed discussion of some of the risks that could require a start up risk premium in Figure 2 and in the Oxera report accompanying the paper⁹³⁹. This includes reference⁹⁴⁰ to regulatory work on these matters in GD14⁹⁴¹ and there is some discussion on low asset values to totex risks. However the Authority notes that none of the risks are quantified and no attempt has been made to justify the premium using a detailed CAPM approach. Overall the Authority does not find the assumptions justifying a premium of 1.5% to be well evidenced.

Duration of the WACC

10.6.34 The application assumes that the long term WACC beyond Year 10 will be 5.5%.⁹⁴² The Authority notes that while the application has increased the WACC in early years because of high risk when looking at asset value to totex spend it does not seem to consider that the WACC could be reduced in later years where the risk when looking at asset value to totex is likely to be less than GB comparators. Therefore the assumptions appear to be inconsistent.

Operating Expenditure

10.6.35 Operating Expenditure – The assumptions to use GD14 figures for some cost items⁹⁴³ is reasonable and robust.

Evidence verifiable from previous experience

10.6.36 The application drew on experience from operating in Great Britain and reviewing previous regulatory decisions in Northern Ireland.

Identification and quantification of risk

Operating Expenditure

10.6.37 Operating Expenditure - We consider that with regard to risk the application is strong⁹⁴⁴. The table provided in the OBP clearly identifies the individual risks,

⁹³⁹ SGN LP Business Plan – page 178-185

⁹⁴⁰ SGN LP Business Plan – page 179

⁹⁴¹ Utility Regulator 2013, GD14 Price Control, Final Determination, 20 December, para 2.19

⁹⁴² SGN LP Business Plan – page 155

⁹⁴³ SGN LP Business Plan – page 128

⁹⁴⁴ SGN LP Business Plan – page 132

assigns each risk with a level of probability and level of impact on the business which are then combined to calculate an overall risk value. Mitigating actions are then identified for each of the highlighted risks.

Efficiency improvement plan

10.6.38 The efficiency improvement plan⁹⁴⁵ identifies three main methods to improve efficiency. These being:

- a. Business processes improvements where suggestions include, actions to reduce non-emergency calls to the emergency call centre and the use of internal rather than contract staff for network operations when economies of scale permit.
- b. Innovation where reference is made to the funding of 150 such projects since 2008 and the ability to apply the outputs from these and future projects to Northern Ireland. A link is made to the Innovation and Technology Transfer submission which the Authority also considered to be strong and well evidenced.⁹⁴⁶
- c. Benchmarking where knowledge gained from the RIIO – GD1 process is discussed and the desire to ensure operations are benchmarked in the upper quartile of GB GDNs is referenced⁹⁴⁷.

10.6.39 The Authority finds the plan to be reasonable with processes as well as specific areas identified to deliver efficiency improvements in NI. The commitment to bringing innovation to NI and reference to benchmarking at the upper quartile of GB GDNs demonstrates good understanding of efficiency improvements. However there could have been more quantification of potential improvements.

10.6.40 We do not accept however that synergies from a connected high and low pressure application of medium pressure with low pressure distribution assets constitute efficiency improvements.

⁹⁴⁵ SGN LP Business Plan – page 134

⁹⁴⁶ Chapter 10.8 of this consultation

⁹⁴⁷ SGN LP Business Plan – p 135

Consideration of responses to the provisional decisions on 3.17(b)

- 10.6.41 As set out in chapter 2 above a number of points were made by firmus in relation to the scoring of SGN's submission on Applicant Determined Costs. firmus stated that in its opinion the Criteria for allocating a mark in relation to the Applicant Determined Costs '*placed undue weight on the fact that the preferred applicant's [i.e. SGN's] submission reported lower operating costs (opex) than other applicants*', and expressed the concern that the assumptions underpinning these figures would turn out to be '*optimistic*'. Therefore, it stated, the Authority's provisional conclusions must carry '*a number of risks for customers in NI*'.
- 10.6.42 However, as firmus concedes, and as has been noted above, the Authority had no discretion as to the treatment of the Applicant Determined Costs⁹⁴⁸. The role of the Authority was to apply the Criteria as set by DETI, and the Criteria have been in place for some time and were subject to extensive consultation for the purposes of the G2W competition before they were framed in their current terms⁹⁴⁹.
- 10.6.43 The Authority considered the point raised by firmus, but was satisfied that it related to the terms of the Criteria, which cannot be amended, rather than to the Authority's application of them. Therefore the Authority considered that this was a point that could not have any bearing on its Final Decision.
- 10.6.44 firmus' response also stated that it would be '*extremely disappointed if the opex allowed for the preferred applicant in the initial G2W price control period were materially higher than that identified in the submission on which the UR's decision was based*'.
- 10.6.45 The Authority noted that this is not a question which bears directly on its provisional or final conclusions as to the preferred applicant, but is instead a question about the conditions of the licence to be granted to the preferred applicant. The Authority's position in relation to the opex allowances is set out more fully in chapter 2.

⁹⁴⁸ Chapter 2.8.8 to 2.8.11 of the Consultation.

⁹⁴⁹ Chapter 1.5.10 to 1.5.16 of the Consultation.

10.6.46 firmus' response also makes some more particular points about the level of resources which SGN proposes to have available (particularly in relation to the management of safety issues).

10.6.47 The Authority notes that safety falls under the remit of HSE(NI). With this in mind we clearly stated in the workbook notes for the low pressure licences that review of safety cases are a matter for the HSE(NI). HSE(NI) will therefore judge what actions are necessary to ensure safety but the allowance will be based on the application. We remain satisfied that SGN in its application demonstrated the necessary skills and experience in relation to system operation, including emergency response and safety.⁹⁵⁰

10.6.48 firmus also makes more general points about the inadequacy of the description by SGN of its derivation of cost data. We noted in arriving at our provisional conclusions that the derivation of SGN costs was difficult to follow in some of the calculations⁹⁵¹ and we also identified a number of errors in the operating expenditure submission. These factors were taken into consideration in arriving at provisional scores for SGN. The Authority therefore remains content with the scores issued to SGN in the provisional determination paper. Accordingly it is not necessary to revisit provisional scores and they can be confirmed.

Final score for 3.17(b)

Weighted Average Cost of Capital

10.6.49 The evidence presented in this application in support of the WACC was strong and well evidenced. There was a comprehensive description and discussion of all aspects of WACC. However the Authority did find that some of the evidence provided to justify some assumptions, in particular the risk premium, was not robust. Overall the Authority finds that in relation to the Weighted Average Cost of Capital the application to be reasonably strong when judged against sub criterion 3.17b.

⁹⁵⁰ Chapter 10.7.9 to 10.7.14 of the Consultation.

⁹⁵¹ Chapter 10.6.13 of the Consultation.

Operating Expenditure

10.6.50 Overall the Authority finds that in relation to Operating Expenditure the application to be moderate when judged against sub criterion 3.17b. The risk section was of good quality but the cost drivers could have been better identified and the failure to provide a spreadsheet was a weakness.

Final Conclusion

10.6.51 Having regard to the OBP and in particular to the matters identified above, the Authority confirms that the SGN application should attract a medium score, and the Authority's final conclusion is to award 14 out of 20 marks.

10.6.52 The Authority remains satisfied that when this mark is compared with those awarded to the other low pressure applicants that it is appropriate when benchmarked against them.

10.6.53 When compared with the other applications, the Authority considered that the SGN application in respect of the WACC section was significantly better than firmus and even further ahead of PNGL. Its overall score was brought down to medium as its Operating Expenditure section was significantly weaker than firmus and slightly weaker than PNGL.

10.7. Specific Criteria – Operational Business Plan 3.17(c)

The experience of the applicant and others on whom it intends to rely in relation to network construction

10.7.1 As discussed above, SGN's existing network in Great Britain consists of 74,000km of distribution network infrastructure located in Scotland and the South of England⁹⁵². Although it has not previously constructed a low pressure network in Northern Ireland, SGN has also worked in Northern Ireland as a maintenance contractor to both NIEH and BGE(UK) for many years.

⁹⁵² Ibid, p. 7.

- 10.7.2 SGN points to the fact that in 2012/13 it replaced or reinforced in excess of 2,500km of mains across its network in GB⁹⁵³, completed 45km of new mains infrastructure to existing housing and completed 17,000 services⁹⁵⁴. It also states that its Network Planning Department designed 1,200km of replacement mains and 1,500km of reinforcement mains in 2012/13, including designs for 78 new district governors⁹⁵⁵. The Authority places weight on SGN's experience in constructing low pressure pipelines in Great Britain.
- 10.7.3 In section 2.3.2 of its OBP, SGN states that until the recruitment of a management team and staff in Northern Ireland, its initial activities in Northern Ireland will be led by its Managing Director (Scotland), Financial Director of Operations and Head of Business Development⁹⁵⁶. Summaries of the skills and experience of these personnel are provided⁹⁵⁷.
- 10.7.4 These individuals will be supported by members of the project team which worked on SGN's bid and summaries of the skills and experience of these personnel are also provided⁹⁵⁸.
- 10.7.5 In relation to external skills and experience, SGN envisages contracting with a local construction firm during month three of mobilisation⁹⁵⁹. It points to the fact that it has long-term framework contracts in place for the supply of the majority of materials necessary to construct the distribution network⁹⁶⁰. In addition, the provision of meters and pressure reduction equipment will be procured from arrangements already in place⁹⁶¹.
- 10.7.6 The Authority considers that SGN has provided detailed information which illustrates that it has the skills and experience required to construct the network and that it has extensive experience of similar activities.
- 10.7.7 In relation to external skills and experience, the Authority notes that some contracts are already in place which will be capable of extension to cover the

⁹⁵³ Ibid, p. 105.

⁹⁵⁴ Ibid, p. 14.

⁹⁵⁵ Ibid, p. 58.

⁹⁵⁶ Ibid, p. 38.

⁹⁵⁷ Ibid, p. 39.

⁹⁵⁸ Ibid, p. 40.

⁹⁵⁹ Ibid, p. 99.

⁹⁶⁰ Ibid, p. 97.

⁹⁶¹ Ibid, p. 98.

new licensed area and where existing contracts are not in place SGN has relevant experience in sourcing and managing appropriate contracts. Although the Authority cannot directly assess either the nature of the contracts which SGN has in place, or the skills and experience of the persons with whom it has such arrangements, the experience upon which SGN can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate.

10.7.8 This view is supported by the report from Rune⁹⁶².

The experience of the applicant and others on whom it intends to rely in relation to network operation

10.7.9 SGN states that it currently manages 74,000km of distribution network infrastructure in Scotland and the South of England and that its two networks have demonstrated a track record in both financial and operational excellence during the recent five year price control (GDPCR1). Its two networks are currently ranked first and second out of the eight networks for opex efficiency and have consistently delivered our 97% emergency standard (a key licence condition) even during extreme winters. The SGN group ranks first throughout GDPCR1 on customer service compared to other ownership groups and has delivered all its mains replacement targets with the Health and Safety Executive⁹⁶³.

10.7.10 In relation to internal skills and experience, SGN has an existing Gas Control Centre in Great Britain and states that this will provide 24/7 network monitoring in the new licensed area.⁹⁶⁴ The Authority places weight on SGN's experience in operating its own control room.

10.7.11 SGN states that it already has robust existing asset records⁹⁶⁵ and asset management systems (e.g. Oracle and Maximo) in place and that these will be applied in the new licensed area⁹⁶⁶. In addition, SGN points to the fact that its asset management system (covering the full asset life cycle) is externally

⁹⁶² RUNE Associates, p. 11.

⁹⁶³ Ibid, p. 7.

⁹⁶⁴ Ibid, p. 34.

⁹⁶⁵ Ibid, p. 87.

⁹⁶⁶ Ibid, p. 88.

certified to BSI PAS55⁹⁶⁷. The Authority notes that SGN is the only applicant to have such certification.

10.7.12 In relation to emergency response to gas escapes, SGN points to the fact that the standards required in Northern Ireland are very similar to those that apply in SGN's existing networks in Great Britain and that it has a track record of achieving or exceeding the applicable 97% standard, including during the severe 1:50 winter of 2010/11⁹⁶⁸. However, it is not clear what processes and procedures for emergency response will be put in place in Northern Ireland as SGN recognises that its procedures in Great Britain will need to be customised for the Northern Ireland context⁹⁶⁹.

10.7.13 In relation to external skills and experience, SGN state that emergency call handling will be managed under an existing contract with National Grid⁹⁷⁰ and that it plans to use the current Northern Ireland Emergency Gas Number⁹⁷¹.

10.7.14 The Authority considers that SGN has provided detailed information which illustrates that it has the skills and experience required to operate the network and that it has extensive experience of similar activities.

10.7.15 In relation to external skills and experience, the Authority notes that some contracts are already in place which will be capable of extension to cover the new licensed area and where existing contracts are not in place SGN has relevant experience in sourcing and managing appropriate contracts. Although the Authority cannot directly assess either the nature of the contracts which SGN has in place, or the skills and experience of the persons with whom it has such arrangements, the experience upon which SGN can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate.

10.7.16 This view is supported by the report from Rune⁹⁷².

⁹⁶⁷ Ibid, p. 88.

⁹⁶⁸ Ibid, p. 89.

⁹⁶⁹ Ibid, p. 90.

⁹⁷⁰ Ibid, p. 32.

⁹⁷¹ Ibid, p. 91.

⁹⁷² RUNE Associates, p. 14.

Securing, mobilisation and management of resources

- 10.7.17 SGN's proposals in regard to securing, mobilising and managing the required resources to construct the low pressure network are based on experience from the arrangements established in relation to the construction of its existing networks in Great Britain.
- 10.7.18 In relation to the mobilisation of the internal resources necessary to construct the low pressure network, sections 2.1.1 and 2.1.2 illustrate respectively SGN's Group Structure, incorporating the new SGN(NI) business unit, and the proposed organisation structure under the Director NI⁹⁷³. Information regarding the roles of those personnel reporting directly to the Director and the rationale for the proposals are provided⁹⁷⁴.
- 10.7.19 SGN states that the initial activities necessary to create the business in Northern Ireland will be managed by the Managing Director, Scotland, the Director of Financial Operations and the SGN Head of Business Development, supported by the bid team⁹⁷⁵. However, a management team and staff for the new business in Northern Ireland will need to be recruited.
- 10.7.20 The Authority notes that a contingency plan is in place if such recruitment is unsuccessful and considers that SGN has demonstrated, on the basis of its previous experience, that it has a pool of relevant resources within the organisation to draw from in that eventuality.
- 10.7.21 SGN also states that it expects to draw on expertise within its group of companies for specialist requirements such as safety, health and environment, regulatory support, procurement and legal services. It also states that it will establish Managed Serviced Agreements (MSAs) for centralised services where significant economies of scale can be gained⁹⁷⁶.
- 10.7.22 Although SGN does not have a contract in place for construction, it states that, as an existing operator of two large networks, it has strategic long-term framework contracts in place for the supply of the majority of materials

⁹⁷³ SGN, op cit, pp. 18 – 20 .

⁹⁷⁴ Ibid, p. 19.

⁹⁷⁵ Ibid, p. 38.

⁹⁷⁶ Ibid, p. 47.

necessary to construct the distribution network⁹⁷⁷. Contracts for other services such as emergency call handling will also be provided under existing contracts⁹⁷⁸.

10.7.23 SGN recognises, however, that as a new entrant to the Northern Ireland market it will need to establish a range of additional service contracts during both construction and ongoing operations⁹⁷⁹.

10.7.24 The Authority also considers that (apart from construction) arrangements are either in place with contractors for the key activities needed, or that existing arrangements can be extended to cover the new licensed area. Although the Authority cannot directly assess either the nature of the contracts which SGN has in place, or the skills and experience of the persons with whom it has such arrangements, the experience upon which SGN can draw in relation to the construction and operation of similar networks is sufficient indication that such arrangements can be viewed as appropriate.

10.7.25 Where arrangements are not in place, SGN has provided information which demonstrates that it has the skills and experience in relation to low pressure networks necessary to secure and manage any additional resource needed.

10.7.26 The Authority considers that SGN has provided detailed proposals on securing, mobilisation, and management of, the internal and external resources necessary to construct the low pressure network.

10.7.27 This view is supported by the report from Rune⁹⁸⁰.

The experience of the applicant and others on whom it intends to rely in relation to achieving connections

10.7.28 SGN has provided information illustrating a strong track record of achieving connections in Great Britain. For example, it notes that during the last five years it has delivered around 100,000 new connections and has significantly exceeded

⁹⁷⁷ Ibid, p. 97.

⁹⁷⁸ Ibid, pp. 97 and 32.

⁹⁷⁹ Ibid, p. 99.

⁹⁸⁰ RUNE Associates, pp.18 and 23.

its fuel poor connection targets with more than 20,000 customers connected to date⁹⁸¹.

10.7.29 However, the Authority notes that SGN has no direct experience of achieving connections in Northern Ireland and so lacks a marketing team, an established brand and relationships with suppliers and gas installers in Northern Ireland.

10.7.30 SGN states that its Head of Business Development will play a key role in the establishment of the business in Northern Ireland⁹⁸², taking responsibility for establishing and maintaining the business relationships and strategic partnerships in order to deliver connection targets⁹⁸³. However, the Authority notes that the supporting Business Development team will need to be recruited and that the process of establishing the relationships necessary to drive connections will therefore not start until the mobilisation period.

10.7.31 As the Authority would expect, SGN recognises that the development of a network of installers and retailers is crucial to future connection growth. However, recognising that it does not currently have these relationships in Northern Ireland, SGN states that it will need to form strategic partnerships with suppliers, heating system installers and other organisations and that it has explored this concept with its affiliate company Airtricity⁹⁸⁴.

10.7.32 SGN states that it intends to create a separate brand for any licensed business in Northern Ireland⁹⁸⁵ but also states that it recognises the importance of promoting gas in Northern Ireland as a whole and that it will work with other distribution network operators and suppliers as appropriate to present consistent messages to the public⁹⁸⁶.

10.7.33 The Authority notes that SGN's approach to marketing connections to gas draws on its experience in Great Britain and employs strategies not currently used in Northern Ireland, such as interest free loans for boilers⁹⁸⁷.

⁹⁸¹ SGN, op cit, p. 7.

⁹⁸² Ibid, p. 10.

⁹⁸³ Ibid, p. 19.

⁹⁸⁴ Ibid, p. 104.

⁹⁸⁵ Ibid, p. 15.

⁹⁸⁶ Ibid, p. 108.

⁹⁸⁷ Ibid, p. 109.

10.7.34 It is clear from the OBP that, while SGN has systems which support supply competition in Great Britain, these will need to be reviewed and tailored to the circumstances of the Northern Ireland market⁹⁸⁸. There is no indication in the OBP of the scale of any such changes to systems to render them appropriate for application in the new licensed area. SGN merely points to the fact that engagement with suppliers will be necessary to review and adopt their existing network code and the systems and interfaces necessary for supply point administration, the co-ordination of meter installation works and information flows with suppliers⁹⁸⁹.

Developing relationships with business and social landlords

10.7.35 SGN affirms the importance of developing the relationships necessary to drive connections and points to having taken a collaborative approach with local authorities, private partners and third-sector organisations in Great Britain to drive new connections and system extensions⁹⁹⁰.

10.7.36 However, the Authority notes that SGN does not have established relationships in Northern Ireland although there is some evidence that it has begun to develop the relationships necessary to drive connections in the new licensed area. For example, SGN states that it has already engaged with NIHE, mapped the locations of its properties and has an understanding of its existing budget plans for heat replacement over the next few years.⁹⁹¹ The OBP also indicates who SGN's Business Development team will establish relationships with potential industrial and commercial customers, local chambers of commerce and local installation businesses but that this engagement will not start until the mobilisation period⁹⁹².

Connections to vulnerable customers

10.7.37 In relation to experience of promoting connections to vulnerable customers, SGN points to its track record in Great Britain in regard to connections to fuel poor customers and its support for vulnerable customers. For example, it states that

⁹⁸⁸ Ibid, p. 117.

⁹⁸⁹ Ibid, p. 115.

⁹⁹⁰ Ibid, pp. 104 and 109.

⁹⁹¹ Ibid, p. 111.

⁹⁹² Ibid, p. 113.

since 2009 it has operated an Assisted Connections Scheme which has delivered over 17,000 connections to fuel-poor or vulnerable customers, outperforming SGN's original targets⁹⁹³.

10.7.38 Also, SGN points to its ability to establish partnerships which can be used to develop proposals for connections to vulnerable customers. For example, SGN states that, in relation to the provision of gas connections under CERT⁹⁹⁴, it developed a fuel switching scheme with supplier partner SSE and latterly with Carillion Energy Services to provide energy saving measures and offset connection charges to customers by some £3m⁹⁹⁵.

10.7.39 In terms of proposals to promote connections to vulnerable customers, SGN references the availability of NISEP funding⁹⁹⁶ and states that it proposes to use a proportion of any owner-occupier marketing allowance in support of providing connections to those who are vulnerable but may not qualify for NISEP funding⁹⁹⁷.

10.7.40 Otherwise, the Authority notes that the OBP contains few specific proposals in relation to the connection of vulnerable customers in the Northern Ireland context.

Consideration of responses to the provisional decisions on 3.17(c)

10.7.41 As set out in chapter 2 above, The firmus response to the provisional decisions noted that the provisional preferred applicant for the low pressure licence (SGN) '*proposes to enter into a Joint Venture (JV) arrangement*' with the preferred applicant for the high pressure licence (NIEH).

10.7.42 It then expressed a number of 'assumptions' about the joint venture, namely that:

- a. the Authority had seen a '*fully documented and formalised JV*';
- b. the joint venture was negotiated on arm's length terms, and that the

⁹⁹³ Ibid, p. 104.

⁹⁹⁴ Carbon Emissions Reduction Target.

⁹⁹⁵ SGN, op cit, p. 114.

⁹⁹⁶ Northern Ireland Sustainable Energy Programme

⁹⁹⁷ SGN, op cit, p. 110.

Authority is satisfied that there is no scope for cross-subsidy;

- c. the Authority has been provided with adequate comfort that the joint venture was formed in accordance with applicable procurement legislation; and
- d. the Authority has been provided with details as to the basis on which SGN will extend its existing contracts to accommodate the extension of its operations to Northern Ireland.

10.7.43 The Authority's approach to the information and evidence provided by each of the applicants, and its use in assessing the applications against the Criteria, was clearly set out at Chapter 1.5.17 to 1.5.24 of the provisional decisions.

10.7.44 As to the joint venture between NIEH and SGN, Chapter 5.5.17 of the provisional decisions stated:

'The Authority was satisfied in principle that, where an applicant lacks the skills and experience to meet some of the obligations under the conditions of the high pressure licence, a contractual joint venture with an organisation possessing the relevant skills and experience was an appropriate means by which the required resources could be accessed. The Authority noted that NIEH stated that its JV with SGN was already established, and that this was reflected in the fact that the organisations had made connected applications for the high and low pressure licences.'

10.7.45 The Authority considered firmus' arguments, but did not consider that they ought to have any weight in its assessment for the purposes of the Final Decision as there was no requirement to review the joint venture in detail.

10.7.46 The Authority was not provided by either SGN or NIEH with a copy of a '*fully documented*' joint venture agreement and, as explained in Chapter 1.5.17 to 1.5.24 of the Consultation, the Authority assessed all applications only on the basis of such information and evidence as was provided.

10.7.47 Indeed the Authority noted that it was not provided with contractual documentation by any of the applicants, including firmus itself, whose 'partnership' with BGE(UK) – an entity which, at the time at which the provisional

conclusions were reached, was no longer part of the same corporate group as firmus – was a relevant feature of both its connected and unconnected applications⁹⁹⁸.

10.7.48 The Authority would have considered any such information if provided, but would not necessarily have expected to see it, and in any event would not have expected to assess it for such matters as the legality of the procurement process by which it was established.

10.7.49 In the case of NIEH and SGN, the Authority was sufficiently satisfied by reference to the clear information provided by both applicants, reflected in the fact of connected applications made by them, that a joint venture arrangement was in place. It also noted that, unlike firmus and BGE(UK), neither applicant submitted an unconnected version of its connected application.

10.7.50 Should the preferred applicants be granted the G2W licences, they will be subject to the conditions of their licences, and each will have the regulatory responsibility – amenable to the Authority's powers of enforcement and sanction – for ensuring that their underlying contractual arrangements are adequate to enable them to comply with their obligations. This is a standard regulatory treatment of all licence holders, and the Authority considered there to be no reason to depart from it in the case of the G2W licences.

10.7.51 With regard to cross-subsidies, the Authority noted that there would be conditions of the G2W licences in place which would be designed to identify any prohibited cross-subsidy. These conditions will be subject to further public consultation before they are made or modified, and all stakeholders will have the opportunity to make further representations at that time. Any concern (implicit in its response) that firmus has as to the adequacy of those conditions can be raised as part of that consultation process and is not of direct relevance to the Final Decision.

Final score for criterion 3.17(c)

10.7.52 The Authority considers that SGN has provided detailed information in respect of

⁹⁹⁸ See, for instance, Chapters 7.5.7 and 8.5.7 of the Consultation.

most of the elements of subparagraph 3.20(b) of the Criteria. The Authority notes that there are few specific proposals in relation to the connection of vulnerable customers in the Northern Ireland context.

10.7.53 The Authority notes SGN's experience of construction and system operation and its proposals for mobilisation based on its experience in Great Britain. The Authority places weight on SGN's experience in operating its own control room.

10.7.54 However, the Authority also notes that the management team and staff in Northern Ireland need to be recruited, including the Business Development team that will be responsible for establishing the relationships that will generate connections. In addition, the Authority notes that SGN does not have an established brand in Northern Ireland.

10.7.55 On the basis of the above the Authority confirms that its final decision is to award a score of 14 marks out of 20 to SGN's application in relation to paragraph 3.17(c).

10.8. Specific Criteria – Innovation & Technology

10.8.1 SGN has sought to address innovation and technology transfer in an annex to its OBP (the ITT).

10.8.2 The ITT does not address the matters listed in paragraph 3.21 of the Criteria systematically. Instead it outlines SGN's current innovation strategy and process, its history and capability, and its existing projects.

Environmental sustainability

10.8.3 In relation to measures to ensure sustainability with respect to the environment, SGN points to a number of projects with environmental benefits which could be transferred to Northern Ireland from Great Britain. These include the use of cold lay tars containing no volatile organic compounds, alternative reinstatement materials that are more environmentally friendly, and the use of Orpheus regulators which eliminate excavations, bringing environmental savings and

reducing waste to land fill⁹⁹⁹.

- 10.8.4 In particular, the Authority also notes SGN's work on the injection of biomethane into the grid¹⁰⁰⁰. SGN states that it was involved in the UK's first biomethane demonstration project at Didcot Sewage Works, near Oxfordshire, and was also involved in developing and installing the UK's first commercial 'biogas to grid' project at Poundbury estate near Dorchester. Consequently, SGN indicates that it now has twelve projects at various stages of commercial approval or technical discussion, with four expected to be injecting biomethane in 2014.

Efficiency in use of gas and new sources of gas

- 10.8.5 In relation to new sources of gas, and in addition to its work with biomethane, SGN points to its 'Opening up the gas market' project which would open up the market to new sources of gas.
- 10.8.6 The objective of this project is to demonstrate that gas which meets the European Association for the Streamlining of Energy Exchange-gas (EASEE Gas) specification but sits outside the characteristics of gas specified within the Great Britain Gas Safety (Management) Regulations (GS(M)R) 1996 can be distributed and utilised safely and efficiently in Great Britain. For this demonstration, SGN states that it has a unique opportunity to utilise one of its discrete, isolated networks which it operates in remote parts of Scotland¹⁰⁰¹.

Cost efficiency

- 10.8.7 SGN states that cost efficiency is a driver in its innovation projects, in particular the conversion of innovation projects into business-as-usual. SGN describes the benefits of the projects it has underway in Great Britain but does not quantify them in monetary terms¹⁰⁰².
- 10.8.8 However, SGN does state that the amount of revenue year on year accounted for by innovation is increasing¹⁰⁰³.

⁹⁹⁹ SGN, *Low Pressure Operational Business Plan: Innovation Annexe*, p.11 and figure 5 pp.14 – 15.

¹⁰⁰⁰ Ibid, pp. 7 – 8.

¹⁰⁰¹ Ibid, p. 6.

¹⁰⁰² Ibid, pp.14 – 15.

¹⁰⁰³ Ibid, p. 4 and figure 4.

Development of the network to more remote geographical areas

- 10.8.9 SGN points to the 'Opening up the gas market' project described above and states that if demonstrated successfully the project could open up the possibility for decentralised networks to be constructed in more remote areas to be supplied by unconventional gases such as biomethane.

History of innovation

- 10.8.10 SGN details a number of examples of past innovation in Great Britain and the processes which support innovation within the company. A number of examples described appear to push the boundaries of modern technology, in robotics for example¹⁰⁰⁴, or would seem to represent new opportunities for Northern Ireland, such as the 'Opening up the gas market' project.
- 10.8.11 The Authority considers that these examples may be directly relevant to the network in the new licensed area and illustrate an ability to innovate more generally. This view is supported by the report from Rune¹⁰⁰⁵.

Ability to secure funding

- 10.8.12 SGN states that it has a track record of securing funding for innovation in Great Britain via the Network Innovation allowance funded under Ofgem's RIIO framework¹⁰⁰⁶. For example, SGN points to £7m funding for its 'Robotics' project and £2m funding for the 'Opening up the gas market' project which was secured under the Network Innovation competition.
- 10.8.13 The Authority therefore notes that SGN(NI) has provided evidence of its ability to secure funding for innovation specifically. This view is supported by the report from Rune¹⁰⁰⁷.

Transfer of innovation into Northern Ireland

- 10.8.14 SGN points to a number of its current and future projects in Great Britain which

¹⁰⁰⁴ Ibid, p. 6.

¹⁰⁰⁵ Rune Associates, op cit, p. 26.

¹⁰⁰⁶ SGN, ITT, p. 5 – 6.

¹⁰⁰⁷ Rune Associates, op cit.

have the potential to transfer into Northern Ireland.¹⁰⁰⁸ A number of these projects have never been tried before in Northern Ireland. In particular, the Authority notes SGN's approach to bringing gas to remote parts of Scotland¹⁰⁰⁹.

10.8.15 The Authority considers that SGN has therefore provided proposals to transfer innovation into Northern Ireland. This view is supported by the report from Rune¹⁰¹⁰.

Existing skills and experience

10.8.16 SGN does not detail the existing skills and experience of its staff in relation to innovation specifically.

10.8.17 However, as evidence of the importance of innovation within the company, SGN points to the fact that it has a dedicated innovation team and an innovation board which provides overall executive level control and guidance¹⁰¹¹. SGN also states that it operates a suggestions scheme, called 'Ignite' for its staff, project partners, and suppliers who wish to make a suggestion, offer a new product or share an idea. Between 30 and 50 suggestions are received each month¹⁰¹². The Authority therefore notes that innovation is embedded in the company from the top down.

10.8.18 Also, as stated in Paragraph 2.9 above, the Authority considers there to be some overlap between this subparagraph 3.21(b)(iv) of the Criteria and subparagraph 3.21(b)(i) as evidence of a history of innovation is one way in which skills and experience may be demonstrated. SGN has therefore been given credit with respect to subparagraph 3.21(b)(iv) on the basis of the examples of previous innovation described in its ITT.

Final score for the ITT criteria

10.8.19 The evidential burden is on the applicant to provide the Authority with information on which to base its assessment under paragraph 3.21 of the

¹⁰⁰⁸ See the snapshot of current transferable projects and figure 5 which includes a more extensive list of projects, SGN, ITT, pp. 7 – 15.

¹⁰⁰⁹ Ibid, p.10.

¹⁰¹⁰ Rune Associates, op cit, p.26.

¹⁰¹¹ SGN, ITT, p. 4.

¹⁰¹² Ibid, p. 3.

Criteria.

- 10.8.20 In respect of the matters listed in subparagraph 3.21(a) of the Criteria, SGN has provided evidence of its ability to achieve innovation and technology transfer in relation to environmental sustainability and efficiency in the use of gas. It has also put forward an innovative proposal for the development of the network to more remote geographical areas.
- 10.8.21 The Authority would have expected SGN to quantify in monetary terms the benefits of the projects underway in Great Britain, however.
- 10.8.22 In respect of the matters listed in subparagraph 3.21(b) of the Criteria, SGN has provided a number of examples of past innovation and has also demonstrated an ability to secure funding for innovation. SGN does not detail the existing skills and experience of its staff in relation to innovation specifically. However, it has been given credit with respect to subparagraph 3.21(b)(iv) on the basis of the examples of previous innovation described in its ITT.
- 10.8.23 Overall the Authority considers that the submission points to a culture of innovation within the company. SGN is also in a unique position to bring the outputs from innovation within the RIIO framework to Northern Ireland.
- 10.8.24 On the basis of the above, the Authority's confirms that its final decision is to award a score of 16 out of 20 to SGN's application in relation to innovation and technology transfer.

10.9. Resources Criteria

- 10.9.1 As explained in chapter 2 of the provisional decisions¹⁰¹³, the Authority considered there to be a close connection between an applicant's score with respect to the Best Value Criterion and the assessment of whether it has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion. This is because of the substantial overlap in the information which is relevant to each.

¹⁰¹³ Chapter 2, paragraphs 2.7.23 to 2.7.29

- 10.9.2 The Authority therefore used its detailed analysis of the information provided with respect to the Best Value Criterion, as outlined above, as a basis for its assessment of whether SGN has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion.
- 10.9.3 Where an applicant has achieved scores which are consistently within the medium to high parts of the range in the assessment of its OBP it might be expected that its application would reveal a broad adequacy of resources for the purposes of the licence. This is the case even if the Authority's detailed analysis of that applicant's OBP found there to be some inadequacies in the information provided.
- 10.9.4 Where an applicant has been attributed one or more scores which are within the low part of the range in the assessment of its OBP – in other words, where it has achieved less than half of the marks that are available against at least one element of sub-criteria 3.17(a) to (c) – the Authority has considered carefully whether its application reveals an adequacy of its resources.
- 10.9.5 SGN has been attributed scores which fall within the medium to high range in respect of all of the elements of its OBP. Its application was supported by comprehensive, detailed and credible information, systematically addressed the relevant issues, and provided a clear and justified rationale.
- 10.9.6 In particular the Authority took into account that its proposed WACC of 6.2% and 5.5% fell within NERA's plausible range and was such that it would be able to raise the finance required to construct and operate the low pressure network while subject to a revenue control condition embodying that WACC.
- 10.9.7 The Authority's final decision is that SGN has demonstrated that it has the required resources to meet the obligations of the licence and thus has met the Adequate Resources Criterion and the Financial Resources and Standing Criterion.

11.0 Best Value Criterion

11.1. Best Value Criterion

- 11.1.1 The purpose of the Best Value Criterion is to allow the Authority to determine which applicant has made the application which represents the best value for gas consumers in Northern Ireland.
- 11.1.2 That determination is made on the basis of the marks which the Authority has given to applications under paragraphs 3.15, 3.17 and 3.21 of the Criteria.
- 11.1.3 The Authority intends to grant two 'related licences' in the G2W area - one for high pressure pipelines and one for low pressure networks. In such cases, the Best Value Criterion must be applied in accordance with paragraph 3.12(b) of the Criteria.
- 11.1.4 This requires the Authority to first calculate the 'combined score' of all possible 'application pairs'. An application pair is defined in paragraph 3.4(a) of the Criteria as meaning two connected applications or any combination of two unconnected applications. The concept of connected applications is defined in paragraph 3.4(b) of the Criteria as meaning two applications, each for a related licence, each of which identifies the other as an application to which the applicant wishes it to be connected.
- 11.1.5 A combined score is defined by paragraph 3.4(c) of the Criteria as meaning the aggregate of the marks awarded under paragraph 3.14 to the applications within an application pair.
- 11.1.6 Applicants for each of the licences were required to indicate as part of their application whether or not they wished that application to be connected to an application for the related licence. Table 11.1 below sets out the responses received in response to this question from each applicant.

Table 11.1: Response to Annex 3 Schedule 1 Part 6

Licence Applied for	Applicant	Connected	Connected to
High Pressure	NIEH	Yes	SGN Low Pressure
	PNGL	Yes	PNGL Low Pressure
	BGE (UK) Connected	Yes	firmus Connected Low Pressure
	BGE (UK) Unconnected	No	
Low Pressure	SGN	Yes	NIEH High Pressure
	PNGL	Yes	PNGL High Pressure
	firmus Connected	Yes	BGE (UK) Connected High Pressure
	firmus Unconnected	No	

11.1.7 On the basis of this information, the Authority has identified four possible application pairs as set out in Table 11.2 below.

Table 11.2 Application Pairs Identified

Application Pair	High Pressure Licence	Low Pressure Licence
NIEH + SGN	NIEH	SGN
PNGL	PNGL	PNGL
BGE + firmus Connected	BGE (UK) Connected	firmus Connected
BGE + firmus Unconnected	BGE (UK) Unconnected	firmus Unconnected

11.1.8 It is the combined scores for each of the above application pairs to which the Best Value Criterion is then applied using the mechanism set out in paragraph 3.13 of the Criteria. Paragraph 3.13 outlines two scenarios to be used in determining which application represents best value –

Scenario A

An application falls within scenario A where:

- i It constitutes part of the application pair which achieved the highest combined score of all application pairs; and

- ii Each application which forms part of that application pair:
 - a) Meets all of the other criteria applicable to the application (excluding the Best Value Criterion); and
 - b) Is not withdrawn by the applicant before the licence is granted.

Scenario B

An application falls within scenario B where:

- i No application falls within scenario A;
- ii The application constitutes part of the application pair which achieved the second highest combined score of all application pairs; and
- iii Each application which forms part of that application pair:
 - a) Meets all of the other criteria applicable to the application (excluding the Best Value Criterion); and
 - b) Is not withdrawn by the applicant before the licence is granted.

11.2. Available Marks and Weightings

11.2.1 Under paragraph 3.14(a) of the Criteria, it is for the Authority to determine the maximum number of marks available. Paragraph 3.14 of the Criteria then sets out the relative weightings of the marks available in respect of an applicant's Applicant Determined Costs, OBP and proposals in regard to innovation and technology transfer.

11.2.2 As stated in chapter 2 of the provisional decisions, the Authority has determined that the maximum number of marks available will be 100 marks. Therefore the number of marks available in respect of each element of an application to be assessed as part of the Best Value Criterion is as follows:

- Applicant Determined Costs - 50 marks;

- Operational Business Plan - 40 marks;
- Innovation and Technology Transfer - 10 marks.

11.3. Applicant Determined Costs

11.3.1 As set out in paragraph 3.15 of the Criteria, marks are awarded for Applicant Determined Cost on the basis of the amount of each application's costs relative to other applications for the same licence. In accordance with paragraph 3.15 of the Criteria, the Applicant Determined Cost is the net present value of costs as calculated in the Data Input Workbook provided by the Authority in the Applicant Information Pack¹⁰¹⁴.

11.3.2 Taking together the requirements of paragraph 3.15 and the Authority's determination as to the maximum number of marks available in respect of the Applicant Determined Costs:

- The application with the lowest net present value of costs is awarded 50 marks.
- Each other application is awarded 50 marks less 1% of the available marks - in this case 0.5 marks - for every 0.2% that its net present value exceeds that of the application with the lowest net present value. Therefore, if an application's net present value is 1% above that of the applicant with the lowest net present value, it receives 50 marks less 5% of 50 marks (2.5 marks) giving a total of 47.5 marks.
- Under subparagraph 3.15(b)(iii), an application with a net present value which is 20% or more above that of the application with the lowest net present value will receive zero marks.
- When measuring the difference between the net present value of any application and that of the application with the lowest net present value,

¹⁰¹⁴ In the case of the high pressure licence this was Annex 9 of the Applicant Information Pack while for the low pressure licence it was Annex 10.

the measurement of that difference shall be rounded up or down to the nearest 0.2%.

High Pressure Licence

11.3.3 On 29 April 2014, and following a public consultation, the Authority published its determination on the mechanism it would use to compare high pressure licence applications in respect of their Applicant Determined Costs¹⁰¹⁵. Applying that mechanism, those applications seeking licence conditions which allow operating cost pass through have had an adjustment factor of 0.22% added to their WACC resulting in an uplifted net present value.

11.3.4 Table 11.3 below sets out the unadjusted and adjusted net present value figures taken from the Data Input Workbooks included in each of the four applications.

Table 11.3 Impact of High Pressure Adjustment Factor

Application	Unadjusted NPV £m	Adjustment Factor	Adjusted NPV £m
PNGL	47.721	Yes	49.665
NIEH	55.007	Yes	57.155
BGE (UK) - Connected	105.118	No	105.118
BGE (UK)- Unconnected	105.558	No	105.558

11.3.5 Table 11.4 overleaf, sets out the award of marks for high pressure licence applications applying paragraph 3.15 of the Criteria to the adjusted net present values for each application.

¹⁰¹⁵ http://www.uregni.gov.uk/publications/utility_regulator_conclusions_-_approach_to_comparing_high_pressure_licence

Table 11.4 Marks for Applicant Determined Cost (High Pressure)

Application	NPV £m	% of lowest NPV	Marks Deducted	Marks Awarded
PNGL	49.665	100.00%		50.0
NIEH	57.155	115.08%	-75%	12.5
BGE (UK) - Connected	105.118	211.65%	-100%	0.0
BGE (UK)- Unconnected	105.558	212.54%	-100%	0.0

Low Pressure Licence

11.3.6 In completing their Data Input Workbook, applicants for the low pressure licence were required to set the domestic tariff at a level which resulted in allowed and collected revenue being equalised over the 40 year period. This was to reflect the impact of the Profiling Adjustment which the Authority proposed to include in the low pressure licence conditions. A check was made to ensure that each application had met this requirement before marks were awarded to each application. This check confirmed that all applicants had completed the Data Input Workbook as required in this respect.

11.3.7 Table 11.5 below sets out the marks awarded by the Authority to the applications for the low pressure licence applying paragraph 3.15 of the Criteria.

Table 11.5 Marks for Applicant Determined Cost (Low Pressure)

Application	NPV £m	% of lowest NPV	Marks Deducted	Marks Awarded
SGN	121.163	100.00%		50.0
PNGL	127.685	105.38%	-27%	36.5
firmus - Connected	147.767	121.96%	-100%	0.0
firmus - Unconnected	147.767	121.96%	-100%	0.0

11.4. Operational Business Plan

11.4.1 In line with the Authority's determination that the total number of marks available in respect of each application is 100, and in accordance with the weightings discussed above, 40 marks are available in respect of the OBP.

11.4.2 Applying the weightings for each element of the OBP outlined in paragraph 3.18 of the Criteria, the marks available in respect of each relevant subparagraph are as follows –

- 3.17(a) - 8 marks;
- 3.17(b) - 20 marks;
- 3.17(c) - 12 marks.

11.4.3 To ensure a consistent approach to scoring as between each of the subparagraphs, and to allow more finely grained distinctions to be drawn between applications, the Authority initially scored each application out of a total of 20 marks in respect of each of the subparagraphs. Each mark out of 20 was then adjusted to reflect the appropriate weighting in respect of each subparagraph as outlined above¹⁰¹⁶.

High Pressure Licence

11.4.4 The final marks awarded by the Authority in respect of subparagraphs 3.17(a), (b) and (c) of the Criteria are set out in chapters 3 to 10 above. Table 11.6 below sets out the marks out of 20 in respect of each of these subparagraphs and it also shows the marks when weighted according to the requirements of paragraph 3.18 of the Criteria.

Table 11.6: Final OBP Scores (out of 20) and marks awarded – High Pressure

Application	OBP Scores Awarded		
	3.17 a	3.17 b	3.17 c
BGE (UK) Connected	18	9	15
BGE (UK) Unconnected	18	9	15
NIEH	16	15	15
PNGL	6	4	7

¹⁰¹⁶ So for example in the case of 3.17 a the ratio is 0.4, maximum marks 8 / maximum score 20. Therefore a score of 10 results in 4.00 marks being awarded, 10×0.4 .

<i>Conversion Factor</i>	OBP Weighted Marks Awarded			
	<i>0.4</i>	<i>1.0</i>	<i>0.6</i>	
	3.17 a	3.17 b	3.17 c	Total
BGE (UK) Connected	7.20	9.00	9.00	25.20
BGE (UK) Unconnected	7.20	9.00	9.00	25.20
NIEH	6.40	15.00	9.00	30.40
PNGL	2.40	4.00	4.20	10.60

Low Pressure Licence

11.4.5 The final marks awarded by the Authority in respect of subparagraphs 3.17(a), (b) and (c) of the Criteria are set out in chapters 3 to 10 above. Table 11.7 below sets out the marks out of 20 in respect of each of these subparagraphs and Table 11.7 also shows the marks when weighted according to the requirements of paragraph 3.18 of the Criteria.

Table 11.7 Final OBP Scores (out of 20) and marks awarded – Low Pressure

<i>Application</i>	OBP Criterion Scores Awarded			
	3.17 a	3.17 b	3.17 c	
firmus Connected	16	14	16	
firmus Unconnected	16	14	16	
SGN	14	14	14	
PNGL	16	10	16	
<i>Conversion Factor</i>	OBP Criterion Marks Weighed Marks Awarded			
	<i>0.4</i>	<i>1.0</i>	<i>0.6</i>	
	3.17 a	3.17 b	3.17 c	Total
firmus Connected	6.40	14.00	9.60	30.00
firmus Unconnected	6.40	14.00	9.60	30.00
SGN	5.60	14.00	8.40	28.00
PNGL	6.40	10.00	9.60	26.00

11.5. Innovation & Technology Transfer

11.5.1 The final marks awarded by the Authority to each application in respect of innovation and technology transfer are set out in chapters 3 to 10, section 8. Applying the weightings as set out in paragraph 3.14(b) of the Criteria, 10% are available in respect of innovation and technology transfer.

11.5.2 As with the OBP, for the purposes of consistency and to allow more finely grained distinctions between applications, applications were scored out of 20. Each score was then divided by two to provide the required mark out of 10.

High Pressure Licence

Table 11.8 Innovation & Technology Transfer Final Scores (out of 20) and Marks Awarded – High Pressure

Application	Innovation & Technology Transfer	
	Score	Marks
BGE (UK) Connected	9	4.50
BGE (UK) Unconnected	9	4.50
NIEH	15	7.50
PNGL	7	3.50

Low Pressure Licence

Table 11.9 Innovation & Technology Transfer Final Scores (out of 20) and Marks Awarded – Low Pressure

Application	Innovation & Technology Transfer	
	Score	Marks
firmus Connected	12	6.00
firmus Unconnected	12	6.00
SGN	16	8.00
PNGL	12	6.00

11.6. Total Marks Awarded

High Pressure Licence

11.6.1 Table 11.10 below summarises the total marks awarded to each application for the high pressure licence.

Table 11.10 Total Marks – High Pressure Licence

Application	Applicant Determined Cost	Operational Business Plan	Innovation & Technology Transfer	Total
BGE (UK) Connected	0.00	25.20	4.50	29.70
BGE (UK) Unconnected	0.00	25.20	4.50	29.70
NIEH	12.50	30.40	7.50	50.40
PNGL	50.00	10.60	3.50	64.10

Low Pressure Licence

11.6.2 Table 11.11 below summarises the total marks awarded to each application for the low pressure licence.

Table 11.11 Total Marks – Low Pressure Licence

Application	Applicant Determined Cost	Operational Business Plan	Innovation & Technology Transfer	Total
firmus Connected	0.00	30.00	6.00	36.00
firmus Unconnected	0.00	30.00	6.00	36.00
SGN	50.00	28.00	8.00	86.00
PNGL	36.50	26.00	6.00	68.50

11.7. Combined Scores for Application Pairs

11.7.1 In table 11.2 above the Authority identified all the potential application pairs that can be created from the individual licence applications. As stated above, combined scores are calculated by aggregating the total marks granted to each application within an application pair. The combined score for each application pair is shown in Table 11.12 below, which also ranks each application pair from highest to lowest on the basis of those combined scores.

Table 11.12 Application Pairs – Combined Score

Application Pair	Combined Score		
	High	Low	Combined
NIEH + SGN	50.4	86.0	136.4
PNGL	64.1	68.5	132.6
BGE + firmus Connected	29.7	36.0	65.7
BGE + firmus Unconnected	29.7	36.0	65.7

11.8. The Preferred and Reserve Applicants

11.8.1 As described above, paragraph 3.13 of the Criteria provides the mechanism by which the application is identified which provides the best value to gas consumers in Northern Ireland.

11.8.2 For an application to fall within either scenario A or scenario B as outlined in paragraph 3.13 of the Criteria, it, and any application connected to it, must (i) meet all of the other criteria excluding the best value criteria, and (ii) not have been withdrawn prior to the grant of the relevant licence.

11.8.3 At the time of publishing no application has been withdrawn.

11.8.4 As set out in Chapter 6 above, the high pressure application submitted by PNGL does not meet the Adequate Resources and Financial Resources and Standing Criteria in paragraphs 2.8, 3.9 and 3.10 of the Criteria. Therefore, neither that application, nor the PNGL application for the related low pressure licence with which it formed an application pair, can fall within scenario A or B.

11.8.5 On this basis, Table 11.13 repeats Table 11.12 above but includes only those applications which are capable of falling within either scenario A or B.

Table 11.13 Applications capable of falling within scenario A or B

Application Pair	Combined Score		
	High	Low	Combined
NIEH + SGN	50.4	86.0	136.4
BGE + firmus Connected	29.7	36.0	65.7
BGE + firmus Unconnected	29.7	36.0	65.7

11.8.6 On the basis of this analysis those Applications which fall within scenario A are:

- NIEH high pressure application;
- SGN low pressure application.

11.8.7 The Authority has therefore determined NIEH to be the preferred applicant in respect of the high pressure licence and SGN to be the preferred applicant in respect of the low pressure licence.

11.8.8 Those applications which are capable of falling within Scenario B are:

- BGE (UK) high pressure Connected Application;
- BGE (UK) high pressure Unconnected Application;
- firmus low pressure Connected Application;
- firmus low pressure Unconnected Application.

11.8.9 The Authority has therefore determined BGE(UK) to be the reserve applicant in respect of the high pressure licence and firmus to be the reserve applicant in respect of the low pressure licence.

12.0 Next Steps

12.1. Grant of licences

12.1.1 Following publication of this document the next step is the grant of licences.

12.1.2 The statutory process for granting the licences is set out in article 8(4) the Gas (Northern Ireland) Order 1996. This requires the Authority to publish notice of its intention to grant each of the licences and to provide a period of not less than 28 days for representations with respect to the proposed licences.

12.1.3 In line with its statutory obligations the Authority will publically consult on the conditions in each licence. The Authority will then finalise the conditions in each of the licences following consideration of any responses which it has received.

12.1.4 The table below sets out an indicative timetable for the steps identified above. The Authority reserves the right to vary (including by adding to) the activities and dates set out in this timetable at its discretion. Any such variation will be communicated via the Authority's website.

Activity	Party	Dates
Public Consultation on final licence conditions	Authority	December 2014
Final Licence(s) Granted	Authority	January 2015

Appendix A: Responses received to the consultation

The responses received to the consultation on provisional decisions can be viewed at the following links:

[BGE\(UK\) Ltd](#)

[NIEH](#)

[firmus energy](#)

[Scotia Gas Networks Ltd](#)

[SSE Airtricity](#)

Appendix B: Glossary

Acronym	Meaning
ACER	Agency for the Cooperation of Energy Regulators
AGI	Above Ground Installation
BGE	Bord Gáis Eireann – Now renamed Eirvia from June 2014
BGTL	Belfast Gas Transmission Limited
BGTP	Belfast Gas Transmission Pipeline
CBI	Confederation of British Industry
CHP	Combined Heat and Power
CNG	Compressed Natural Gas
DEL	Department for Employment and Learning
DETI	Department of Enterprise, Trade and Investment
DRD	Department for Regional Development
DSD	Department for Social Development
ENTSO-G	European Network of Transmission System Operators for Gas
EST	Energy Saving Trust
EU	European Union
EUS	Energy Utility Skills
FMA	Fingleton McAdam
FOIA	Freedom of Information Act
FTE	Full Time Equivalent
G2W	Gas to the West

Acronym	Meaning
GD14	Gas Distribution Price Control 2014
GDN	Gas Distribution Network
GTMB	Gas Trading Management Booking System
GTW	Gas to the West
HP	High Pressure
HSE	Health and Safety Executive
IC	Industrial Commercial
ITT	Innovation and Technology Transfer
JV	Joint Venture
LNG	Liquefied Natural Gas
LP	Low Pressure
MEL	Mutual Energy Limited
MERC	Maintenance and Emergency Response Contractor
MLAs	Members of the Legislative Assembly
NEC	New Engineering Contract
NERA	National Economic Research Associates
NFU	National Farmers Union
NIEA	Northern Ireland Environment Agency
NIEH	Northern Ireland Energy Holdings
NIHE	Northern Ireland Housing Executive
NISEP	Northern Ireland Sustainable Energy Programme
NPV	Net Present Value

Acronym	Meaning
NTP	Network Transformation Programme
OBP	Operational Business Plan
Ofgem	The Office of Gas and Electricity Markets
Ofwat	The Water Services Regulation Authority
PE	Polyethylene Pipe
PES	Phoenix Energy Services
PFI	Private Finance Initiative
PMC	Project Management Contractor
PNGL	Phoenix Natural Gas Limited
PTL	Premier Transmission Limited
RIIO	Revenue = Incentives + Innovations + Outputs
Rune	Rune Associates
SCADA	Supervisory Control and Data Acquisition
SGN	Scotia Gas Networks
SNIP	Scotland to Northern Ireland Pipeline
TSO	Transmission System Operator
UK	United Kingdom
UR	Utility Regulator
WACC	Weighted Average Cost of Capital

Appendix C: Economic Terms

Term	Meaning
Asset beta values	A measure of volatility, to an asset's sensitivity to non-diversifiable risk, which is referred to normally as systematic risk or market risk, of a security or a portfolio in comparison to the market as a whole.
Capital Asset Pricing Model (CAPM)	A model that is used throughout the investment community, which describes the relationship between risk and expected return, using well understood financial metrics that are used in setting an appropriate rate of return.
Capital reserves	<p>A type of account on a company's balance sheet that is reserved for long-term capital investment projects or any other large and anticipated expense(s) that will be incurred in the future.</p> <p>It should be noted that capital reserves are not available for distribution as dividends.</p>
Cost of Equity	The expected rate of return on investment that is required by a company's shareholders. The return consists both of dividends and capital gains (e.g. increases in the share value).
Equity Risk Premium values	The return an investor would require over and above the risk free rate of return.
Gearing ratio	A measure of the equity (or capital) in the business versus the level of debt borrowed.
iBoxx index	The iBoxx bond market indices are benchmarks for professional use and comprise liquid investment grade bond issues. They enable investors to analyse and select benchmarks that reflect their investment profile.

Term	Meaning
Liquidity	The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterised by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.
Pass through costs	Cost that are approved in allowances, which are not controllable e.g. Licence Fees.
Postalisation	It effectively means the charges for conveying a therm of gas through designated pipelines will be the same regardless of the distance that it is conveyed or the number of pipelines through which it is conveyed.
Price Cap	The maximum allowed charge to consumers for running the business, with a strong incentive to outperform on demand forecasts.
Revenue Cap	A levelised annual revenue stream or charge to consumers that enables the business to operate, even after a significant drop off in demand.
RIIO	Revenue = Incentives + Innovations + Outputs. This is the Price Control as used by OFGEM, which is the Regulator for Great Britain, which covers Gas and Electricity
Risk Free Rate	The risk free rate represents the interest an investor would expect from an absolutely risk free investment over a specified period of time.
Systematic risk	Inherent risk or undiversifiable risk which applies to the whole market, and cannot easily be mitigated against.

Term	Meaning
Total Market Return to Equity	The amount of net income returned as a percentage of shareholders equity.
UK gilts	Bonds that are issued by the British government.
Weighted Average Cost of Capital (WACC)	<p>This metric covers all the sources and metrics necessary to finance a business, which ranges from sourcing of debt, existing debt, risk free rate of return, gearing, tax, risk premiums, market volatility, return and cost of equity, market conditions, etc.</p> <p>This is the expected rate of return required by investors. It includes both the cost of debt to a firm, and the cost of equity.</p>
Working Capital	<p>The working capital is calculated as:</p> <p>Working Capital = Current Assets – Current Liabilities.</p> <p>The working capital ratio (Current Assets/Current Liabilities) indicates whether a company has enough short term assets to cover its short term debt.</p>

Appendix D: Overview of Applicants

Applicant	Company Overview
Bord Gáis Eireann (UK)	<p>BGE (UK) Limited is a subsidiary company of Bord Gais Eireann (BGE), which is an Irish Semi-State body responsible for the delivery of gas and water infrastructure. BGE (UK) owns and operates parts of the Transmission gas network in Northern Ireland.</p> <p>BGE (UK) developed and owns the North West Pipeline (NWP), which is 112 kilometers in length and runs from Carrickfergus to Coolkeeragh Power Station. BGE (UK) also operates the 156 kilometer South North Pipeline (SNP), which runs from Co. Antrim to Gormanston, Co. Meath where it links into the NWP.</p> <p>It should be noted that BGE has been renamed Ervia as of June 2014.</p>
firmus energy Distribution Ltd	<p>firmus energy Distribution Ltd currently operates along the North West Pipeline (NWP) and South North Pipeline (SNP). It has approximately 70,000 customers in Northern Ireland and is connecting approximately 4,250 customers per annum.</p> <p>Since 2005 firmus have laid over 870km of mains pipes across Northern Ireland.</p> <p>firmus is 100% owned by the Icon Group.</p>
Northern Ireland Energy Holdings (NIEH)	<p>NIEH is a wholly owned subsidiary of Mutual Energy Ltd. Mutual Energy is a company limited by guarantee (often called a mutual company) which was formed to acquire and hold important energy infrastructure assets for the benefit of the energy consumers of Northern Ireland. Moyle Interconnector Limited, Premier Transmission Limited and Belfast Gas Transmission Limited are all part of the Mutual Energy Group.</p>

Applicant	Company Overview
	<p>Premier Transmission Ltd, operates a licence for the conveyance of gas in Northern Ireland which is regulated by the Utility Regulator.</p> <p>Premier Transmission Ltd owns and operates the 135km Scotland to Northern Ireland Pipeline (SNIP) which runs from Twynholm in Scotland to Ballylumford Northern Ireland.</p> <p>Northern Ireland Energy Holdings Ltd. is 100% owned by Mutual Energy.</p>
Phoenix Natural Gas	<p>Phoenix currently operates a licence granted to it in 1996 for the conveyance of natural gas (at distribution level) in Northern Ireland. Under the terms of the licence, Phoenix is authorised to conduct its gas distribution business within an area covering approximately 40 per cent of the population of Northern Ireland: Greater Belfast.</p> <p>Gas is available (in accordance with the terms of the licence) to circa 301,000 properties within the existing Licensed Area, of which circa 171,000 (57 per cent) have been connected to the network.</p> <p>Phoenix Natural Gas is 100% owned by the Hastings Group.</p>
Scotia Gas Networks Northern Ireland (SGN)	<p>Scotia Gas Networks Northern Ireland is a subsidiary of Scotia Gas Networks which is the second largest operator of gas distribution infrastructure in the UK. SGN owns and operates gas transportation and distribution networks in Scotland and the south and south-east of England.</p> <p>The Company is owned by three shareholders:</p> <ul style="list-style-type: none"> • SSE plc (50%); • Borealis Infrastructure Europe (UK) Limited (25%), which is indirectly wholly owned by OMERS Administration

Applicant	Company Overview
	<p>Corporation; and</p> <ul style="list-style-type: none"> OTPPB Investments (U.K.) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board.